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No. 83-909

# In the Supreme Court of the United States

OCTOBER TERM, 1983

UNITED STATES OF AMERICA,
*Respondent,*

v.

HARRY S. STONEHILL,
ROBERT P. BROOKS, et al
LOURDES BLANCO STONEHILL,
PACITA C. BROOKS, et al,
*Petitioners.*

*On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit*

**PETITION FOR WRIT OF CERTIORARI**
**By ROBERT P. BROOKS**
**TO THE UNITED STATES COURT OF APPEALS**
**FOR THE NINTH CIRCUIT**

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## QUESTIONS PRESENTED FOR REVIEW

I

Where the government utilizes secret criminal grand jury proceedings to elicit evidence against a citizen in a civil tax case without notice and a court-ordered disclosure upon a showing of particularized need, should this Court strike down the subsequent civil proceedings which are irreparably tainted by such unauthorized conduct as improper *per se*?

II

Where millions of dollars in federal income tax are imposed upon the bases of an erroneous jeopardy assessment and crucial findings of fact confessedly not based on evidence, the following important questions of law arise:

A.

Whether presumptions of correctness may arise or survive where no evidence of deficiencies in unreported income support the original or altered tax assessments.

B.

Whether a federal income tax liability, in any amount, may be permissibly derived from a substantially incorrect jeopardy assessment, without some evidence of taxable income.

## LIST OF PARTIES

United States of America
Harry S. Stonehill
Robert P. Brooks
Lourdes Blanco Stonehill
Pacita C. Brooks
Trammell, Rand, Nathan & Lincoln
Lourdes Blanco Stonehill Childrens' Trust
Elizabeth Ann Stonehill and the Elizabeth Ann Stonehill Trust
Susan Jane Stonehill and the Susan Jane Stonehill Trust
Harry Steven Stonehill, Jr. and the Harry Steven Stonehill, Jr. Trust
Michael Joseph Stonehill and the Michael Joseph Stonehill Trust
Pacita C. Brooks Children's Trust
Mary Jane Brooks Moore
Virginia Mae Brooks
Charles A. Brooks
Richard A. Brooks
Kenneth C. Brooks
Pine Street Management Corporation
Marinship Enterprises, Inc.
The Harroman Company, Inc.
The Makiki Corporation
William W. Saunders
Ira Blaustein
Wells Fargo Bank American Trust Company

Peter O. Mattei
Ben Gromet
Jim Cyrus
Richard N. Rapoport
Sidney P. Rudy
Tierra Ranch, Inc.
Contracts Discount, Inc.
John E. Fort
Julius Barr & Co.
Title Insurance and Trust Company
Sam Steinberg
Irving Sulmeyer
Holexa, S. A.
Petramonte Productions Corporation Establishment
Stonehill Family Trust
Tower Development Corporation
Merriweather Development Corporation
California Street Corporation
Palo Corporation
The Brookstone Corporation
Swiss Bank Corporation
Northwestern Savings and Loan Association
Heath Land Company
Kurt Heath
Nathan Berke
Jane Ratney

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No. _____

# In the Supreme Court

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OCTOBER TERM, 1983

UNITED STATES OF AMERICA,
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v.
HARRY S. STONEHILL, et al,
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LOURDES BLANCO STONEHILL,
PACITA C. BROOKS, et al,
*Petitioners.*

*On Writ of Certiorari to the*
*United States Court of Appeals for the Ninth Circuit*

**PETITION FOR WRIT OF CERTIORARI**
**By ROBERT P. BROOKS**
**TO THE UNITED STATES COURT OF APPEALS**
**FOR THE NINTH CIRCUIT**

Petitioner Robert P. Brooks respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit so as to rectify not only the conflict created by the Ninth Circuit regarding the application of a presumption of correctness to a naked jeopardy tax assessment not premised on any income figures but also the improper *per se* unauthorized use of secret grand jury proceedings to concoct a civil tax case.

While the former issue presented herein is identical to that presented by a separate petition filed simultaneously by taxpayer Harry S. Stonehill, the latter question is raised only by Mr. Brooks.

## REPORTS OF OPINIONS BELOW

The decision of District Judge Gus J. Solomon appears in *United States* v. *Stonehill*, 420 F.Supp. 46 (C.D. Cal. 1976) (Appendix C).

The United States Court of Appeals for the Ninth Circuit (Judges William T. Canby, William A. Norris, and Stephen Reinhardt) rendered its opinion on April 8, 1983; that opinion has been officially and unofficially reported as follows: *United States* v. *Stonehill*, 702 F.2d 1288 (9th Cir. 1983); 83-1 U.S.T.C., p. 9285; 51 AFTR 2d 83-1152 (Appendix A). On April 21, 1983, Petitioners filed a timely Petition for Rehearing and Suggestion For Rehearing en Banc. On September 1, 1983, the Ninth Circuit entered its written opinion denying the petition; that opinion has not been reported, officially or unofficially (Appendix B).

An earlier related case concerning most of the same parties but involving different questions of law (propriety of taxpayers' motion to suppress) appears in *Stonehill* v. *United States*, 274 F.Supp. 420 (S.D. Cal. 1967), 405 F.2d 738 (9th Cir. 1968), *reh den.* 405 F.2d 738 (9th Cir. 1969), *cert den.* 395 U.S. 960, 89 S.Ct. 2102, 23 L.Ed. 2d 747, *reh den.* 396 U.S. 870, 90 S.Ct. 39, 24 L.Ed. 2d 125 (1969).

## GROUNDS FOR SUPREME COURT JURISDICTION

The District Court for the Central District of California, the District Court for the Northern District of California and the District Court for the District of Hawaii entered judgments on October 14, 1980 (CR 732, 733, 734 respectively). Petitioner filed timely

notices of appeal to the United States Court of Appeals for the Ninth Circuit in the District Court for the Central District Court of California on December 5, 1980 (CR 738), in the District Court for the Northern District of California on December 8, 1980 (CR 739), and in the District Court for the District of Hawaii on December 9, 1980 (CR 740). The Ninth Circuit consolidated these appeals on petitioner's motion on January 22, 1981 (CR 754).

The United States Court of Appeals for the Ninth Circuit rendered its judgment affirming the judgments of the district courts on April 8, 1983. *United States* v. *Stonehill, supra,* 702 F.2d 1288 (9th Cir. 1983) (Appendix A). Petitioner timely filed a Petition for Rehearing and Suggestion for Rehearing En Banc in the Ninth Circuit on April 21, 1983. The Ninth Circuit denied this petition on September 1, 1983 (Appendix B).

28 U.S.C. § 1254(1) confers jurisdiction upon the Supreme Court of the United States to review the judgments herein by writ of certiorari. 28 U.S.C. § 2101(c) provides that a petition for a writ of certiorari shall be filed within ninety days after entry of the judgment of the Ninth Circuit.

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Constitution of the United States, Amendment V

26 U.S.C. § 63(a), (b)
26 U.S.C. § 6212
26 U.S.C. § 6861(b), (c)

26 U.S.C. § 7401
26 U.S.C. § 7402
26 U.S.C. § 7403
28 U.S.C. § 1254(1)
28 U.S.C. § 1291
28 U.S.C. § 1340
28 U.S.C. § 1345
28 U.S.C. § 2101(c)

The text of these provisions appear in Appendix E.

## FEDERAL RULES INVOLVED

Federal Rule of Criminal Procedure 6(e)

The text of this Rule appears in Appendix J.

## STATEMENT OF THE CASE

### I. The Chronology

On January 18, 1965, the Commissioner of Internal Revenue filed jeopardy income tax assessments against taxpayers, Harry D. Stonehill and Robert P. Brooks.

On January 25, 1965, the Government commenced foreclosure actions against the taxpayers in the United States District Courts for the Central and Northern Districts of California and the District of Hawaii.

On March 18, 1965, Notices of Deficiency, 26 U.S.C. § 6861, were issued by the Government against the taxpayers.

On February 24, 1975, the Government conceded error in its jeopardy assessments and notices of deficiency for failure to recognize and apply Philippine Community property law.

On May 27, 1975, the Government announced its election as to its case in chief to rely on the presumption of correctness and to abandon the net worth reconciliation theory of liability. See Appendix D.

On May 27, 1975, the trial on the merits of the issue of tax liability commenced. The Government filed two exhibits marked Exhibits 1 and 2 (Appendix F) and rested its case in chief. Appendix D.

On May 27, 1975, the trial on the merits of the civil fraud issue commenced. (5/27/75 A.M. Session, RT 64, *et. seq.*) The government tendered 36 volumes of unidentified documents as evidence. (5/27/75 A.M. RT 36, *et. seq.*) These documents were provisionally admitted subject to connection. (5/27/75 A.M. Session, RT 44, 48)

On July 23, 1976, the opinion of District Judge Gus J. Solomon was filed and designated as Findings of Fact and Conclusions of Law. The opinion is published at 420 F.Supp. 46 (CD Cal. 1976). The district court found taxpayers liable for deficiencies in federal income tax.

On July 31, 1979, Judge Solomon made additional Findings of Facts which were not published. (CR 711)

On April 8, 1983, the United States Court of Appeals for the Ninth Circuit affirmed the liability of taxpayers. The opinion is reported at 702 F.2d 1288 (9th Cir. 1983).

**II. The Case**

This case concerns the assertion of liability for

federal income taxes where the government elected to file no income figures. Although the government conceded that any income subject to taxation would also be subject to the community property law of the Philippines (2/24/75, RT 6-7, CR 1040; 5/27/75, RT 12-13), no income calculations giving effect to that governing law were ever introduced.[1]

Thirty-six volumes were proffered to the court and provisionally admitted into evidence on the civil fraud issue. (5/27/75 A.M. Session, RT 36 *et. seq.*) These volumes largely were not disturbed by the government and were referred to at times by the court and counsel as "the junk pile" (3/30/76, RT 215-216, CR 1045).[2]

---

[1] This fatal flaw in the government's case was rationalized by the Ninth Circuit, *U.S.* v. *Stonehill, supra,* 702 F.2d at 1297:

> "This fifty-fifty split made by the district court in allocating the community property interest was reasonable in the absence of other indications; the taxpayers have not shown it to be incorrect. The judgment thus rests securely on the prima facie case created by the assessments."

Of course, the Philippine community property law speaks for itself. As the record adduced at the special hearing on February 24, 1975 demonstrates, the Philippine community property law cannot be treated that simplistically. The lead IRS agent, as a government witness, *conceded* that a "fifty-fifty split" (The language of the Ninth Circuit) would not be correct:

> "JUDGE SOLOMON: Is the prayer of your complaint reduced by 50 percent?
>
> "MR. BIGGINS [government attorney]: If I may ask informally, Mr. Ragland, who will make some computations, it comes to in the neighborhood, I believe Mr. Ragland can comment on that.
>
> "MR. RAGLAND: No, it won't come to 50 percent. It will be different." (4/25/75 RT 326).

[2] As the Ninth Circuit noted, *U.S.* v. *Stonehill, supra,* 702

Nothing retrieved from the "junk pile" and properly presented to the court on the fraud issue demonstrated any income figures. The only income figures presented to the court came attached to a post-trial brief. (5/20/81 TR 31; 12/20/76 RT 24-26) This was the first occasion upon which the court was advised of the then abandoned net worth computations originally prepared for this case. The district court showed appropriate interest:

> "THE COURT: Well, are you contending that attaching the net worth figure to the brief is the equivalent of having admitted it in evidence?
>
> "MR. BIGGINS: Well, coming to the second point, I thought it was based on the taxpayers' concession. I think the Court could have taken judicial notice at that time. Whether it did or not I don't know." (5/20/81 RT 31)
>
> . . . . .

---

F.2d at 1293, on March 3, 1962, some 200 Philippine agents illegally seized *thirty-five truckloads* of documents from taxpayers and seventeen corporations. U.S. agents were permitted access to these documents for review and copying. The U.S. government copied some 35,000 documents (about 2 full file cabinets). The rest of the documents were returned to the Philippine government where they were later destroyed by a typhoon. Taxpayers never had access to these records (except to the selected copies made by the government) after the 1962 raid.

What the Ninth Circuit does *not* note, however, is the testimony of lead IRS agent Ragland who bore principle responsibility for ascertaining the alleged deficiencies and preparing the statutory notice calculations:

> "Q. You photographed those that you thought would be interesting?
>
> "A. That were of interest in developing our case, yes, sir." (Ex. GGG at 126; *See* Ex. EEE at 252, 305-307, 228-230).

"THE COURT: All right. I conclude that the Government intended to rely on the assessment, the jeopardy assessment.

"MR. BIGGINS: That's correct" (5/20/81 RT 42).

The Ninth Circuit also observed the lack of income figures, 702 F.2d at 1295, n.10, "The status of the net worth calculations was somewhat unclear. The district judge based portions of his opinion upon them. 420 F.Supp at 59-61."

The trial on the merits, held more than ten years after the government filed its complaint, lasted less than three days. The government attempted to prove tax liability by offering in evidence only the certificates of jeopardy assessment. Appendix D. It then rested. The next issue, civil fraud, was tried with equal expedience by the introduction of 36 indexed volumes containing copies of documents. (5/27/75 A.M. Session, RT 36, *et. seq.*) No testimony was adduced as to the predicates, relevance or intended use of the particular papers. The taxpayers' objections (e.g. 12/20/76, RT 24-26) were founded in part on the total lack of income figures in evidence. The trial judge noted on December 20, 1976:

"THE COURT: *And the Government elected to proceed on the basis of the presumption of validity. They were stuck with that theory.* They decided they wouldn't go into the evidence." (12/20/76 RT 21) [Emphasis supplied.]

Upon this basis the court *directed* government counsel to return to the 1965 jeopardy assessment figures (Ex.

1, 2; App F) and to make adjustments for the admitted and determined overstatements in asserted tax produced by the failure to consider three major income adjustments including the arbitrary community property "fifty-fifty split." (12/20/76 RT 24-26, 34-35; 10/29/77 RT 48, 73-76, CR 1047); see, 702 F.2d at 1297. The government then proceeded to work backwards via tax tables from an unsupported "tax" figure on a bare jeopardy assessment for which no evidence was given to an equally hypothetical "income" figure upon which the trial court based its final judgment as to the amount of tax due (5/5/78 RT 53 *et. seq*) See findings, January 31, 1979, CR 711.

The District Court not only ordered these substituted findings of fact on January 31, 1979 without reference to its published opinion (CR 711), but also acknowledged post-trial that his original findings and conclusions contained in his 1976 opinion were the product of "grievous error" and wholly unsupported by any record evidence:

> "THE COURT: It might be. But I am equally surprised that for five years, nobody ever called my attention to the error, the grievous error that I made on Pages 60, 61, 62, in which I discussed these various items." 5/20/81 RT 69-70, CR 767.
>
> ". . . . .
>
> "Well, I forgot a couple of pages. Starting in from 57, 58, 59, 60, 61, 62, the major portion of my opinion, no one ever told me until today that all of this was irrelevant to any issue that was properly before me." 5/20/81 RT 70, CR 767.
>
> ". . . . .

"I'm surprised that I spent the major portion of my opinion on matters that were never admitted in evidence and nobody ever called my attention to it." 5/20/81 RT 75, CR 767.[3]

The trial judge *a fortiori*, abandoned his published Findings of Fact and Conclusions of Law and rested his judgment solely upon the factual foundation of the bare assessments.

Despite the innuendo below concerning the political and business activities of Mr. Stonehill and Mr. Brooks, not only in the Philippines and the United States but also throughout the world, neither man has ever been tried or convicted of any related criminal charge. The Ninth Circuit wrote that an attack was begun against taxpayers in a State Department inter-office memorandum dated January 10, 1962. *United States* v. *Stonehill, et al, supra*, 702 F.2d at 1291, n. 4. See Exhibit AAA, subexhibit C-6. *See also*, Ex. AAA, Vol. II at 51. This memorandum, including "the only attack that can be made on Stonehill is through IRS", was quoted extensively in the Ninth Circuit opinion. *Ibid.* It is uncertain as to what judicially worthy ends these quotes were intended. But, in fairness, the author should be quoted fully. The Revenue Service Representative for Southeast Asia also advised the IRS Office of International Operations in Washington:

"In the States we heard chiefly of government corruption as a problem in Central and South Ameri-

[3] Taxpayers *did* call the Court's attention to these fundamental errors on numerous occasions; *e.g.* 5/27/75 RT 97-99; 12/20/76 RT 24-26; 10/20/77 RT 75-76; See generally Appendix D.

> ca but it is the considered opinion of responsible people who have had extensive experience in Central and South America, as well as the Philippines, that the Philippines has the most corrupt government in the world. This is probably attributable to the fact that Filipinos as a race, lack both racial and national pride and have an almost total lack of moral integrity. This state of conditions has to be fully understood before you can grasp this situation at all." (Ex. AAA, C-2).

The Ninth Circuit did concede that at least some of the evidence upon which the court based its findings of fact was not in the record, *Ibid* at 1295; however, the Opinion below did *not* address the fact that the trial court had, on the record, characterized these written findings as based on matters not properly before it and erroneous and had entered a judgment based solely upon the bare tax assessment, the presumption of correctness and on supplemental findings correcting the assessments. The Ninth Circuit circumvented these defects by holding that where the government advises a taxpayer of its position, the taxpayer becomes obligated to rebut that position even if the government declines to introduce any evidentiary support for its thesis. *Ibid* at 1295, 1297. Application of this new rule to the present case produced an extraordinary burden of proof because the "figures" upon which the appellate court necessarily must have relied had been abandoned and repudiated *by the Government* before trial.[4] Since application of community property law universally requires *de novo* computations, all the King's horses and all the King's men could not have put the original Government figures together again.

The Ninth Circuit also based its opinion on its assumption that there existed sufficient substantive evidence of unreported income in the "junk pile" evidence (admitted for the limited purpose of proving civil fraud) to permit the presumption to attach the assessment. *Ibid* at 1293. Even if this were true, it would not relieve the government of its obligation to provide specific income computations upon which to justify its amount of tax.

The Ninth Circuit indicated fraud was shown by monies "having flowed into secret Swiss bank accounts belonging to the taxpayers". *Ibid* at 1294. The District Court had found the accounts were corporate accounts; there was no evidence of secrecy. *U.S.* v. *Stonehill, supra*, 420 F.Supp. at 62. The Ninth Circuit, 702 F.2d 1296, correctly reported that the government did not claim that these were secret amounts of the taxpayers but instead "while in the Swiss accounts, the money was in the sole control of the taxpayers." A constructive dividend theory was applied to these funds on

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[4] The original assessment figures referred to by the Ninth Circuit cannot be classified as "notice" in any event to the taxpayers. The original four-year jeopardy assessment against Mr. Stonehill was $7,869,374.55 (Ex. 1, Appendix F); the District Court's substituted findings assessed a deficiency against him for $2,852,620.71 (CR 711). The original four-year jeopardy assessment against Mr. Brooks was $6,503,-611.80 (Ex. 2, Appendix F); the substituted judgment figure was $2,767,025.80 (CR 711). The breadth of the error also appears when one compares the 1958 jeopardy assessment against Mr. Stonehill of $395,100.53 (Ex. 1, App. F) with the substituted findings of the trial judge of 2.7% of that amount or $10,938.84 (CR 711). Of course, all of the foregoing figures, large or small, are truly hypothetical. Only income figures can be used to generate federal income taxes.

equivocal testimony by lead IRS agent Ragland:

> "They are not necessarily personal funds. They were under their directions and control and they were used to plow back into their investment in this company. In other words, say I started out in '57 with a hundred thousand dollars. I have my books only show $800,000, but I take the $200,000 and buy machinery and contribute it back to the company.
>
> "The $200,000 was mine, for an instance [sic], when I made the decision to purchase the machinery, to purchase it and put it into the company so it was mine at that point. I could have done something else with the $200,000. I could have sent it to Switzerland. The fact that I choose to put it back in company was my decision." (Ex. FFF at 707-708).

It was not until close to the end of the three-day trial on the merits that the Government suddenly told the Court that its original deficiencies were derived by treating corporate monies which were used to buy commodities and pay for services outside of the Philippines as personal income:

> "THE COURT: Let me ask you the next question: In determining the amount of the deficiency, did you include in Stonehill's assets and in his taxable income, the amount which he got which was returned to the corporation?
>
> "MR. BIGGINS: In part in assets, yes.
>
> "THE COURT: I don't see how you can prevail under those circumstances.
>
> "MR. BIGGINS: They owned eighty-five per cent of the corporation.
>
> "THE COURT: That wouldn't make any difference. Were these Philippine corporations?

MR. BIGGINS: Yes. (5/29/75 RT 285-286, CR 1042).

. . . . .

". . . I have learned now that some of this money came back to the United States Tobacco and Cigarette Company, a corporation in which Stonehill and Brooks held substantial interest. But the mere fact that Stonehill and Brooks owned eighty-five per cent of the company or sixty per cent of the company doesn't make much difference unless it could be proved that they were merely shells or other names for Mr. Stonehill and Brooks. That seems to me would be pretty difficult in view of the fact some of these corporations were public corporations in which part of the ownership belonged to third parties. . . ." (5/30/75 RT 398-399).

". . . In other words, can the Government say this was income to Stonehill and Brooks? If I have an interest in a corporation, the assets of which increased from one hundred thousand to ten million dollars, I don't pay taxes on that, even though I would own ninety per cent of the company . . ." *Ibid* at 399.

See generally, 5/29/75 RT 287-290; 5/30/75 RT 397-400.

## BASIS FOR FEDERAL JURISDICTION OF COURTS BELOW

Jurisdiction in the respective United States District Courts rested on the provisions of 28 U.S.C. §§ 1340, 1345, and 26 U.S.C. §§ 7401-7403, I.R.C. 1954.

Jurisdiction of the United States Court of Appeals for the Ninth Circuit rested upon 28 U.S.C. § 1291.

## REASONS FOR GRANTING THE WRIT

### I. This Civil Tax Case Against Petitioner Brooks Was Irreparably Tainted By The Unauthorized Government Use of Secret Criminal Grand Jury Proceedings

1. On June 30, 1983, this Court handed down two landmark decisions which provide a compelling reason for granting Mr. Brooks' Petition for Writ of Certiorari: *United States* v. *Sell Engineering, Inc.*, — U.S. —, 103 S.Ct. 3133, 77 L.Ed.2d 743 (1983) (hereinafter referred to as "*Sells*") and *United States* v. *Baggot*, — U.S. —, 103 S.Ct. 3164, 77 L.Ed. 2d 785 (1983) (hereinafter referred to as "*Baggot*").

For many years, government criminal prosecutors habitually employed the tactic of providing secret criminal grand jury materials to their civil counterparts in the Internal Revenue Service and elsewhere, to aid the latter in developing a civil claim against grand jury targets or witnesses. *Sells*, *supra*, 103 S.Ct. at 3154, 3156 (dissent). The majority in *Sells*, *supra*, held that the policy undergirding Fed. R. Crim. P. 6 compelled adherence to traditional standards of secrecy; therefore, the automatic disclosure exception authorized by Fed. R. Crim. P. 6(e)(A)(i) must be limited to those government attorneys who conduct the criminal procedures to which the grand jury materials pertain, *Sells*, *supra*, 103 S.Ct. at 3140, and access by civil government attorneys may be permitted under Fed. R. Crim. P. 6(e)(3)(c)(i) only when the government moves for court-ordered disclosure under the rule and makes the required showing of particularized need, *Sells*, *supra*, 103 S.Ct. at 3136, 3149.

This Court amplified the *Sells*, *supra*, doctrine in the contemporaneous *Baggot*, *supra*, decision where the majority held that an Internal Revenue Service investigation to determine a taxpayer's civil tax liability is not "preliminar[y] to or in connection with a judicial proceeding", *Baggot*, *supra*, 103 S.Ct. at 3165; therefore, the Internal Revenue Service cannot meet the "particularized need" test necessary to secure Court-ordered disclosure of secret Grand Jury Proceedings under Fed. R. Crim. P. 6(e)(3)(C)(i) for use in determining potential civil tax liability. *Baggot*, *supra*, 103 S.Ct. at 3167.

At trial, the government introduced a transcript of the testimony of taxpayer Stonehill taken before the Grand Jury in Honolulu, Hawaii on February 21, 1961 (four years *before* the jeopardy assessments levied herein) as Government General Exhibit 3 over the objections of the petitioner (5/27/75 RT 59-60).

In summer 1960, U.S. Attorney (Hawaii) Louis B. Blissard investigated taxpayer Stonehill at the behest of the Internal Revenue Service (Ex. I, MM); this investigative net eventually incorporated Petitioner Mr. Brooks, an American citizen who had been interred in a Japanese concentration camp during World War II and who, upon cessation of hostilities, had become a junior associate or minority shareholder in some of Mr. Stonehill's businesses (*e.g.*, Govt. Gen. Ex. 3, p. 18). Mr. Stonehill was seized and served with a summons at 9 a.m. February 21, 1961 in the Honolulu airport as he changed planes (Govt. Gen. Ex. 3, p. 5). The questioning in the Grand Jury proceedings cleverly disguised

the target (eg. Govt. Gen. Ex. 3, p. 2-7, 9, 10, 24, 26-29). The first link in this investigation to Mr. Brooks occurred during Mr. Stonehill's testimony (Govt. Gen. Ex. 3, p. 18). The Grand Jury and the U.S. Attorney adroitly fostered the chimera that these proceedings were secret and the testimony would not be used against the taxpayers (e.g. Govt. Gen. Ex. 3, pp. 23, 27, 29, 30). Mr. Brooks received no notice of the proposed use of these proceedings in any civil case. No court ordered disclosure to the Internal Revenue Service.

Thereafter, the State Department determined to employ the Internal Revenue Service as a means of removing Mr. Stonehill from the Philippines so as to foster dubious federal foreign policy (Exhibit AAA, Subexhibit C-6). The Internal Revenue Service accelerated its investigation of both Mr. Stonehill *and Mr. Brooks*, specifically identifying the "U.S. Attorney" in "Honolulu" as the "Origin of Information". (Ex. I, MM). None of Mr. Brooks' private papers were seized in the infamous March 3, 1962 raid upon Mr. Stonehill's property.

Thus, the present proceedings fall clearly with the proscriptions of *Sells, supra*, and *Baggot, supra*. U. S. Attorney Blissard violated the *Sells, supra*, doctrine by disclosing secret criminal Grand Jury information to civil attorneys for the government not involved in any criminal prosecution. The government never applied to any court for disclosure of the fruits of the Grand Jury investigation and, of course, never demonstrated any particularized need as mandated by *Baggot, supra;*

indeed, since the civil investigation purported to relate to Petitioner's civil tax liability only, the government could *not* have shown a particularized need "preliminary to or in connection with a judicial proceeding" as compelled by Fed. R. Crim. P. 6 and *Baggot, supra.* In effect, the government has enjoyed an improper *ex parte* form of discovery", *Sells, supra,* 103 S. Ct. at 3143, throughout this entire proceeding. The entire case constructed by the Commissioner against this petitioner, such as it is, rests upon the reed provided by the Grand Jury proceedings. Thus, the government action at the outset irreparably tainted the civil tax case and *Sells, supra,* and *Baggot, supra,* require dismissal of the claims.

Furthermore, the *Baggot, supra,* majority carefully pointed out that the mere fact that litigation may eventually ensue would not alter its holding, *Baggot, supra,* 103 S. Ct. at 3168. Mere determination of the existence of an income tax deficiency and assessment does not necessarily mean that judicial proceedings will follow. *Ibid.* Indeed, in *Baggot, supra,* the taxpayer pleaded guilty to two criminal counts, leading the government to argue ". . .that when the taxpayer has already pleaded guilty to a tax scam, the prospect of exoneration from civil liability is more theoretical than real. . . ." *Baggot, supra,* 103 S. Ct. at 3168, n. 6. The majority rejected this argument in *Baggot, supra. A fortiori,* the assertion cannot apply to Mr. Brooks who hotly contests any civil liability and who was never convicted of any tax crime! In the words of Mr. Justice Brennan in *Sells, supra,* 103 S. Ct. at 3142, "Any such use of

grand jury proceedings to elicit evidence for use in a civil case is improper *per se.*"

Finally, it appears that Mr. Brooks also meets the alternate test proposed by Mr. Chief Justice Burger's dissent in *Baggot, supra*, 103 S. Ct. at 3172.

> "... Accordingly, I would hold that the disclosure sought was 'preliminary to' a judicial proceeding within the meaning of Rule 6(e)(3)(C)(i), and remand for determination whether the government had shown sufficient need for the materials and that it had conducted the grand jury investigation in good faith."

Therefore, at the very least, this Court should remand the case at bar under *Sells, supra*, and *Baggot, supra*, for a determination of compliance with the two-prong test enunciated by the Chief Justice as to petitioner.

**II. Conflict Engendered By Use of Naked Jeopardy Assessment With No Proof of Income**

This Court's teaching in *United States* v. *Janis*, 428 U.S. 433, 96 S. Ct. 3021, 49 L. Ed. 2d 1046 (1977), cannot be reconciled with the decision below.[5] The *Janis* case decided that, where an income tax liability assessment is shown to be naked and without any rational foundation, it is arbitrary and erroneous. 428 U.S. at 442. The conflicts between the federal circuits noticed in *Janis, supra*, 428 U.S. at 441-442, as to burden of proof considerations, have increased in disparity of views so that now the substantive result of

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[5] *United States* v. *Stonehill*, 702 F.2d 1288 (9th Cir. 1983).

litigation may turn more on the views of a Circuit Court of Appeals than upon the federal law of income taxation.[6]

In the instant case, notwithstanding the district court's candid admission of error (e.g. 5/20/81 RT 69-70, 75) the Ninth Circuit has concluded that bare Certificates of Jeopardy Assessment (26 U.S.C. § 6861), unadorned by substantive evidence and conceded by the government to be substantially erroneous, were nevertheless entitled to presumptions of correctness. The admitted error in the assessments, more than 50 percent of the original asserted tax, were found not to affect the remaining parts of the assessment even though such parts were not in evidence and could not contribute to the establishment of a rational foundation.

The decision below is in conflict with the teaching

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[6] The Government failed to establish in the record that it complied with the notice provisions of 26 U.S.C. § 6212. It is conceded that taxpayers had actual notice. In *United States* v. *Ball*, 326 F.2d 898 (4th Cir. 1964), where a taxpayer left the country for an extended period and authorized his secretary to receive his mail, it was stipulated, "that a notice pursuant to § 6303 was sent by certified mail, but that notice is not made part of the record, and any other notice which may have been sent in compliance with § 6212(a) is not made part of the record or referred to therein." *Ibid* at 901-902. The *Ball* case held the failure to be "a defect jurisdictional in nature . . ." *Ibid* at 903. The district court below determined under *Boren* v. *Liddell*, 241 F.2d 670, 672 (9th Cir. 1957), "that technical compliance with the Section 6212(a) is not necessary if the taxpayer receives actual notice. Here there was actual notice." Had taxpayers' case been tried within the Fourth Circuit, it is probable they would have prevailed on the notice-is-jurisdictional holding in *Ball*.

in *Helvering* v. *Tex-Penn Oil Co.*, 300 U.S. 481, 57 S. Ct. 569, 81 L. Ed. 775 (1937), which requires the government to set forth the basis in law and fact justifying every claim of deficiency under the federal tax laws. Many millions of taxpayers reside within the geographical jurisdiction of the Ninth Circuit and such of those taxpayers as may contest a deficiency tax claim will confront disparate practices in the application of federal law if this Court does not grant review to rectify the precedent set by the decision below.

**2a.** The government elected to voluntarily abandon the net worth reconciliation theory of liability.[7] Accordingly, after introducing the jeopardy assessments the government put in no other evidence on the issue of tax liability.[8] Thus, the Notices of Deficiency, 26 U.S.C. § 6212, which constitute the underlying computations for the jeopardy assessments, were intentionally withheld from evidence and cross examination by tax-

[7] "MR. BIGGINS [GOVERNMENT'S COUNSEL]; On the case in chief, *we will go on the presumption* because of the enormous quantity of boxes out there, *to proceed now on the net worth method, would be a trial of two or more months . . .*" (5/27/75, RT 20-21). [Emphasis added]. See also Appendix D.

[8] *United States* v. *Stonehill*, *supra*, 702 F.2d at 1292-1293: "To support the asserted tax deficiencies, however, the government introduced only the jeopardy assessments. The government thus chose to rely on the presumption that the assessments are correct, rather than proving each item of the underlying net worth computations. The jeopardy assessments themselves contained only bare assertions of tax due plus interest and [1293] penalties in each of the four years." The error in this view is the failure to note that the government's lawyer withdrew the government's reliance on the net worth theory. Footnote 3, *supra*.

payers. In the decision below, the failure to adduce this evidence was characterized as an apparent "oversight."[9]

**b.** The legal questions surrounding the application of a presumption that the Commissioner's determinations of tax liability were correct hinge upon whether a rational foundation for such presumption means a fact-based foundation and whether such facts must be before the court as evidence. The record below exhibits the government's concession that the assessments as originally made were incorrect.[10] The jeopardy assessments of record were incorrect in *all* their parts, that is, asserted tax, penalty and interest for each year in question. What next occurred in the salvaging of the presumption of correctness below involved a series of steps dispersed through the opinions of the two lower courts.

The government never altered its position that it would not introduce evidence on the net worth reconciliation theory.[11] The courts below, however, did not

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[9] *United States* v. *Stonehill, supra,* 702 F.2d at 1293. Compare Appendix D.

[10] *United States* v. *Stonehill, supra,* 702 F.2d at 1292. "After pre-trial hearings in 1974, the government conceded that half of the taxpayers' income constituted income to their wives under Philippine community property laws. The wives are not subject to United States income taxation. Therefore, the amount of tax assessed against the taxpayers was halved."

[11] "MR. BIGGINS: I understood both those options, Your Honor, yes. I was confronted with a three or four-month trial or could go on the presumption and I made my decision and I am stuck with it." (3/29/76 RT 92). Appendix D.

let go of the net worth theory. The district court reasoned.[12]

> "In my view, when an assessment has separable parts, the taxpayer has the burden to discredit each part, and the presumption survives for each part that the taxpayer fails to discredit.
>
> . . . . .
>
> "I therefore hold that each part of the Commissioner's determination is entitled to the presumption of correctness . . . ."

The Commissioner's determinations were never *properly* before the trial court.[13] Clearly, they were never filed in the record.

The appellate court noted that the district court held the presumption "applied to the remaining *parts* of the assessment.[14] [Emphasis added]. The courts' use of the word "parts" suggests something more than the interdependent numbers representing tax, penalty and interest shown on the assessment in evidence. And, the court below held, "the parts need not be delineated in the assessment itself.[15] If not in the assessment itself, the only situs of the "parts", under Section 6861, would be the notice of deficiency which was not in evi-

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12 *United States* v. *Stonehill, supra,* 420 F.Supp at 56, 57.

13 The government disingenuously attached a copy of the original net worth computations to a post-trial brief; 12/20/76 RT 24-26; 5/20/81 RT 31. The Ninth Circuit expressed some uncertainty about the net worth computations, 702 F.2d at 1295, footnote 10: "The status of the net worth calculations was somewhat unclear. *The district judge based portions of his opinion upon them.* 420 F.Supp. at 59-61." [Emphasis added].

14 *United States* v. *Stonehill, supra* 702 F.2d at 1295.

15 *Ibid* at 1297.

dence. Thus, the courts below extended a presumption of correctness to "parts" of a deficiency assessment not in the evidence before them. This circumstance produced the remarkable holding that, "no substantial unfairness resulted from the failure to introduce the computations into evidence."[16] Where *Janis, supra*, 428 U. S. at 441, teaches the utter insufficiency of "a 'naked' assessment without *any* foundation", the decision below permits the government to conjure up a foundation without *any* evidence to support it; and in doing so the Ninth Circuit announced a new rule of evidence: knowledge of a purported fact by an adversary party dispenses with the need to file evidence to establish that fact. If valid, this rule would make logically impossible a showing that any naked assessment lacked any rational foundation. *Janis, supra.*

Whether or not the failure to file such evidence was fair or unfair to the taxpayers, a separate question as to the management of the judicial process below is raised: upon what basis could the courts below attach a presumption of correctness to the assessments — essentially a factual inquiry — when the alleged deficiencies in unreported income were not in evidence for the courts' inspection as to rationality or arbitrariness? And, upon what basis is the presumption continued where the assessment in evidence is concededly incor-

[16] The Ninth Circuit did *not* follow this view in *Clark* v. *Commissioner*, 266 F.2d 698, 706 (9th Cir. 1959) where it was held that if evidence shows the deficiency notice could be found inaccurate then the presumption disappears and, "[t]he tax court's determination must then rest on all of the *evidence introduced* and its ultimate determination must find support in credible evidence." [Emphasis added].

rect. In *Bar L. Ranch, Inc.* v. *Phinney*, 426 F.2d 995 (5th Cir. 1970), the Fifth Circuit held "that a taxpayer defending a collection suit need only show that the Government's assessment was arbitrary and that the burden is then on the Government to show whether a deficiency exists and, if so, in what amount. The Fifth Circuit in *Bar L. Ranch, Inc., supra*, followed the view of *United States* v. *Lease*, 346 F.2d 696 (2d Cir. 1965), where the taxpayer consented to the assessment of a deficiency against him for the years in question. The government there, as in the instant case, brought an action to foreclose the tax lien and the taxpayer challenged the correctness of the assessment. Judge Moore collected and reviewed the cases on burden of proof in tax cases and concluded, "that a taxpayer challenging the correctness of a tax assessment, as a defense in a collection case, has the burden of persuading the fact finder by a preponderance of the evidence that the assessment is incorrect. . . ." 346 F.2d at 700. The substantial incorrectness of the assessment was conceded below. Under the view of the Fifth and Second Circuits, the burden of proof would shift to the government, "*and the presumption of correctness of the computation by the Commissioner and assessment with respect to that item disappears* . . . ." 346 F.2d at 701. [Emphasis added.] Again, the taxpayers probably would have prevailed in the Second and Fifth Circuits on the posture and proof of the case below.[17]

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[17] See, *United States* v. *Szerlip*, 169 F.Supp. 529, 531 (E.D. N.Y. 1959), where the government proved the assessment only and the court found it to be erroneous. Judgment was entered for the taxpayer.

**3a.** The matters now addressed are believed to be *without* supporting precedent in this Court or any federal Circuit Court of Appeals. The court below affirmed *sub silentio* a novel method for arriving at an arithmetical resulting figure for each taxpayer which the Government denominated as "income." The court below ignored a confession of grievous error made in the record by the district judge which extended to major portions of his opinion. (5/20/81 RT 69-70, 75)

The startling direction of the trial judge to the government counsel to derive "income" from the tax asserted is a total departure from known case authorities and the tax statutes. Clearly, the district court appreciated the dearth of evidence in the record.[18] The government's attorney did what he believed the trial judge wanted: he derived a figure called "income" by working backwards from assessed tax figures.[19] Whether the income tax assessed figures in a jeopardy

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[18] "THE COURT: Did you file or is the notice of deficiency in evidence in this case?

"MR. BIGGINS: It is not in evidence. When a question arose, I did serve a certified copy as an exhibit with one of our briefs.

"MR. RAND: With one of your briefs?

"MR. BIGGINS: We can make the computations the Court desires. We think we have made them.

"THE COURT: I don't think you can make it on anything that is not in evidence. That is what Mr. Rand is saying." (12/20/76, RT 24).

[19] "MR. BIGGINS: Now, on the third set [CR 711] which I believe are in accordance with the Court's directions, we started on line one, 'Income Tax Assessed' and the assess-

assessment are in evidence or not, where unproved by supporting credible facts (mere assertions awaiting an evidentiary validation), it is clear that tax is a derivative of income and not *vice versa*.[20] Taxpayers do not believe there is any authority for this abberational practice of arriving at a purported income figure by interpolation of asserted tax figures.

**b.** On May 20, 1981, during a post trial hearing ordered by the Ninth District, Judge Gus J. Solomon placed in the record the following confession of error:

> ". . . But I am equally surprised that for five years nobody ever called my attention to the error, the grievous error that I made on Pages 60, 61, 62, in which I discussed various items. . . . Well, I forgot a couple of the pages. Starting in from 57, 58, 59, 60 and 61, the major portion of my opinion, no one ever told me until today that all of this was irrelevant to

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ment in evidence and worked backwards by making interpolation —

. . . .

"It's the one anchored to the tax assessment . . . working backwards from the tax to the income." (CR 1047, 5/5/78 RT 56, 57).

To its credit, the IRS reportedly remonstrated with Mr. Biggins over the correctness of anchoring the adjustments to tax rather than income. *Ibid.*

[20] 26 U.S.C. § 63.

In *Tank Truck Rentals* v. *Commissioner of Internal Rev.*, 356 U.S. 30, 78 S.Ct. 507, 2 L.Ed. 2d 562 (1958), this Court observed, "[i]t is clear that the Congress intended the income tax laws 'to tax earnings and profits less expenses and losses', [citation omitted] carrying out a broad basic policy of taxing 'net, not * * * gross, income * * *.'" 356 U.S. at 509.

any issue that was properly before me." (5/20/81 RT 69-70, CR 767).[21]

This significant record statement was material to the validity of the judicial proceedings and was ignored by the court below, although it was squarely presented for consideration.[22] The matters appearing between pages 59 and 62 of the district court's findings of fact and conclusions of law include the *entire* tax liability findings. Under the District Court's opinion divisional topic heading, "C. The Evidence of Tax Liability", 420 F. Supp. at 57, the court addressed "1. The Community Property Issue", "2. Opening Net Worth", *ibid;* and, "3. Increases in Net Worth", *ibid* at 60.

The particularly pivotal "facts" and "law" recanted by the trial judge under the section on evidence of tax liability include, 420 F. Supp. at 57-62, *inter alia*, (1) the finding that the Commissioner used the net worth method to compute taxpayers' income, (2) opening net worth figures, (3) taxpayers' cash on hand at the beginning of the tax years, (4) recitation of problems in finding all of taxpayers' opening assets, (5) finding the Commissioner made a reasonable and conscientious effort to discover taxpayers' opening assets, (6) finding the Commissioner followed all reasonable leads to obtain taxpayers' opening assets, (7) finding taxpayers failed to show the Commissioners' determination of cash on hand on December 31, 1957 was either incorrect or arbitrary, (8) finding the Commissioner's determination that the payment for the

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[21] See Footnote 3, *supra.*

[22] Taxpayers-Appellants Reply Brief, 10/8/82, pp. 13-14.

barter permit was a personal expenditure, (9) concluding that the payment for the barter permit was a business expense, (10) stating that the Commissioner relied on reports filed with the Philippine Securities and Exchange Commission (PSEC), (11) stating that the Commissioner converted pesos to dollars at the black market rate of exchange, (12) finding that the Commissioner's use of PSEC figures was proper, (13) finding that the Commissioner's distrust of particular accounting records was justified, (14) finding that the Commissioner used the same conversion rate at both the beginning and end of the tax period, (15) finding taxpayers' net worth increased during the tax years 1958 through 1961, (16) finding taxpayers received kickbacks and unreported dividends and interest from investments in the tax years, (17) finding the existence of "likely sources", (18) finding that the Commissioner computed the value of taxpayers closing balances, (19) finding that the Commissioner determined money belonged to taxpayers personally, (20) finding Swiss bank accounts belonged to taxpayers personally, (21) holding the Commissioner properly increased taxpayers' investment in United States Tobacco Company, (22) holding the Commissioners' determination of tax deficiencies were correct, and (23) holding the government was entitled to judgment against taxpayers for tax deficiencies.

There was no evidence of tax liability before the district court because the government never intended to offer such evidence and conceded that the data base of liability was not in the evidence.[23]

[23] 10/20/77, RT 46-48, 74-75; 5/20/81, RT 25-26, CR 767; App. D.

## CONCLUSION

It is self evident that the court below had no evidence before it for judicial review of the issue of income tax liability. The precedent set below cannot be squared with existing pronouncements of this Court or the several Circuit Courts of Appeal and, as has been shown, it conflicts with fundamental rules of law followed by the federal judiciary in deciding income tax cases. All taxpayers residing within the geographical boundaries of the Ninth Circuit will face certain deviation from the federal norm in this genre of case if this precedent is permitted to stand. It is submitted discretionary review is required to settle the conflicts of law posed by this case.[24]

Respectfully submitted,

RIDGWAY K. FOLEY, JR., P.C.
SCHWABE, WILLIAMSON, WYATT, MOORE & ROBERTS

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[24] This Court may find consideration of summary reversal appropriate in this instance because of the number of problems presented and the admitted lack of an evidentiary record upon which to make a careful review.

**APPENDIX A**

UNITED STATES of America
*Plaintiff-Appellee,*

v.

Harry S. STONEHILL, Individually and as Trustee of the Lourdes Blanco Stonehill Children's Trust, The Elizabeth Anne Stonehill Trust, and The Susan J. Stonehill Trust, et al.,
*Defendants-Appellants,*

Trammell, Rand, Nathan & Lincoln, a Partnership, and Pacita Carrion Brooks,
*Intervenors-Appellants.*

Nos. CA 80-4590, 80-4598, 80-4599 and 80-6062

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Oct. 22, 1982.
Decided April 8, 1983.
702 F.2d 1288
[headnotes deleted]

Before CANBY, NORRIS and REINHARDT, Circuit Judges.

CANBY, Circuit Judge:

The government initiated this action to foreclose income tax liens. After trial to the court, the district judge granted judgment in favor of the government. *United States* v. *Stonehill*, 420 F.Supp. 46 (C.D.Cal. 1976). The taxpayers, their wives, their lawyers and certain other parties appeal.

## FACTS

Appellants Harry S. Stonehill and Robert P. Brooks (the taxpayers) are United States citizens who entered business in the Philippines after World War II. They settled in the Philippines and both married Filipino women. They prospered, eventually controlling many successful corporations and wielding great influence in Philippine politics.

In 1950, the taxpayers branched out into the cigarette manufacturing business by establishing the United States Tobacco Company (USTC). Their fortunes brightened considerably after 1958 when one of their companies obtained the first and only exclusive license (barter permit) to import American tobacco into the Philippines. For the license, the taxpayers made payments totalling ten million pesos (three million dollars at the black market exchange rate) to the ultimately victorious Philippine presidential candidate. The license gave the taxpayers a monopoly on Philippine sales of American tobacco, which consumers greatly preferred. USTC, controlled and largely owned by the taxpayers, was the principal beneficiary of the license. USTC bought the American tobacco and manufactured cigarettes for sale in the Philippines.[1] In the first fourteen months after the acquisition of the license, USTC's share in the Philippine cigarette market increased by some 1500% (from a 3.7% share to 58%).

1. The imported tobacco was used in cigarettes sold under the brand names Kent and Old Gold.

The district court found that, between 1958 and 1961, millions of dollars from various Philippine business dealings passed through the taxpayers' hands. Much of this money came from illegal and unrecorded sources.[2] The taxpayers extracted commissions and rebates from exporters and shippers of the American tobacco. They received kickbacks from Philippine manufacturers who were permited to buy imported tobacco, and they siphoned off large sums from USTC and other controlled corporations. Neither the corporate books nor the taxpayers' individual records reflected these transactions. Over nine million dollars flowed through black market channels to secret Swiss bank accounts and "shell" companies. Some of this money paid expenses of USTC in the United States.[3] About four million of these dollars were invested in American real estate and securities. During these years the tax-

2. These illegal dealings were documented by evidence introduced on the issue of fraud. The district court held that the government had proved fraud by clear and convincing evidence. The taxpayers do not contest this portion of the decision.

3. The tobacco barter permit allowed the taxpayers to import ten million pounds of American tobacco on condition that they export fourteen million pounds of Philippine tobacco. Supposedly, the value of the exported tobacco would equal the value imported, and thus prevent any flow of currency out of the Philippines. In fact, American tobacco cost about four times as much as Philippine. The taxpayers therefore needed large sums of money in the U.S. to purchase the American tobacco. Philippine law, however, severely restricted the outflow of currency from the country. Part of the diversion of funds to Switzerland was to evade these Philippine currency restrictions.

payers reported combined incomes of less than $200,000.

In about 1960, both American and Philippine officials became interested in the taxpayers' activities. The United States State Department believed that Stonehill was a corrupt influence on the Philippine government and wanted to get him out of that country.[4] Consequently, the United States Internal Revenue Service began to investigate the taxpayers' affairs.

On March 3, 1962, some 200 agents of the Philippine National Bureau of Investigation raided the offices of the taxpayers and seventeen of their corporations. The agents illegally seized thirty-five truckloads

4. A State Department interoffice memorandum dated January 10, 1962 stated:

> Parsons stated in the opinion of the Embassy it is imperative for American interests in the Philippines that some way be found to get Stonehill out of the Philippines and break his stranglehold here. The reasons for their concern were known to me, although I did not concern my December memorandum with details on the areas not of direct interest to Internal Revenue, nor will I burden the memo with these details. In general, however, Stonehill has had an evil and corrupt influence on the Philippine government in the past and has now indicated that he will manipulate the new administration in the Philippines even more visciously (sic). Whereas the American government is vitally interested in developing and improving the democracy and economy of the Philippines, it appears that Stonehill's individual influence may be sufficient to undermine the entire American effort and perhaps destroy democracy here and the cost to the United States will be immeasurable and much beyond the hundreds of millions involved in the aid programs and loans.

The memorandum concluded that the "only attack that can be made on Stonehill is through IRS."

of documents. Representatives of the United States Internal Revenue Service were permitted to examine these documents, and over 35,000 were eventually copied by the Internal Revenue Service.[5] A three year, worldwide audit ensued. More than fifty revenue agents audited some twenty-five business entities in the United States, the Philippines, Hong Kong, Australia, Japan, Canada, France, England and Germany. Because the taxpayers' records did not accurately reflect income, the Commissioner used the audit information to estimate unreported income by calculating the increase in the taxpayers' net worth. The Commissioner computed tax deficiencies (including interest and penalties) of $13,613,721.51 against Stonehill and $11,182,966.73 against Brooks.

Fearing that the taxpayers, if given time, would try to remove their assets from this country, the Commissioner issued "jeopardy" assessments pursuant to 26 U.S.C. § 6861 against the taxpayers on January 18, 1965.[6] Section 6861 permits the Commissioner to issue

5. The taxpayers' records were never returned to them by the Philippine government. Many of the records were apparently destroyed by a typhoon in 1970.

6. 26 U.S.C. § 6861(a) provides:

(a) Authority for making. —If the Secretary or his delegate believes that the assessment or collection of a deficiency, as defined in section 6211, will be jeopardized by delay, he shall, notwithstanding the provisions of section 6213(a), immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and demand shall be made by the Secretary or his delegate for the payment thereof.

an assessment without first sending the usual notice of deficiency (90 day letter) when collection would be "jeopardized by delay." The filing of the jeopardy assessments created tax liens on the property of the taxpayers. 26 U.S.C. § 6321.[7] One week later, the United States commenced these actions to foreclose tax liens on certain of the taxpayers' properties in the United States.[8]

Years of litigation ensued, involving hundreds of depositions all over the world, dozens of hearings, and three successive judges. Resolution was complicated by the absence of crucial documents and witnesses (including the taxpayers themselves), by sensitive diplomatic and political considerations, and by many charges of misconduct made by both sides. In 1967, the taxpayers made a motion to suppress the evidence illegally seized in the Philippine raids. The district court concluded that the United States had not instigated or participated in the illegal searches and denied the motion. 274 F.Supp. 420 (S.D.Cal. 1967). We affirmed. 405 F.2d 738 (1968), *cert. denied*, 395 U.S. 960, 89 S.Ct. 2102, 23 L.Ed.2d 747 (1969).

After pre-trial hearings in 1974, the government

7. 26 U.S.C. § 6321 is quoted at note 12, *infra*.

8. The government filed suits to foreclose tax liens in the district courts for the Northern District of California, the Central District of California, and the District of Hawaii. The parties have agreed that the judgment of the District Court for the Central District of California shall be entered as the judgments in the other actions.

conceded that half of the taxpayers' income constituted income to their wives under Philippine community property laws. The wives are not subject to United States income taxation. Therefore, the amount of tax assessed against the taxpayers was halved.

Ten years after the action commenced, on May 27-30, 1975, it was tried before Judge Solomon. The government introduced many documents and depositions to prove fraud. To support the asserted tax deficiencies, however, the government introduced only the jeopardy assessments. The government thus chose to rely on the presumption that the assessments are correct, rather than proving each item of the underlying net worth computations. The jeopardy assessments themselves contained only bare assertions of tax due plus interest and penalties in each of the four years. Apparently by oversight, the net worth computations were never put into evidence at all.

The district court upheld the validity of the tax liens. The court adjusted the assessments to correct the treatment of the ten million peso bribe, and to reflect the conceded community property split. Although these adjustments greatly reduced the assessments, the district court held that the taxpayers had not rebutted the presumption of correctness. The district judge also rejected the wives' claim that the tax liens did not encumber their community half interest in the properties. *United States v. Stonehill*, 420 F.Supp. 46 (C.D.Cal. 1976).

After the main trial, Trammell, Rand, Nathan and Lincoln (TRNL), the lawyers representing the taxpayers, intervened to foreclose liens securing legal fees against some of the properties subject to litigation. The district judge rejected their claim, ruling that the TRNL's rights were ineffective against or inferior to the government's tax liens.

Four groups of defendants appeal:

(1) The taxpayers, Harry S. Stonehill and Robert P. Brooks, appeal the finding of tax liability.

(2) Their wives, Lourdes Blanco Stonehill and Pacita C. Brooks, appeal the decision that the liens encumber their community property interest in the properties.

(3) Trammell, Rand, Nathan and Lincoln, the law firm that defended the taxpayers, appeals the district court's ruling that any liens for attorneys' fees that they have upon these properties are invalid against the government.

(4) Finally, certain third parties appeal the judgment on the ground that it extinguished their interests in the property without their having an opportunity to litigate the issue.

## I. *Tax Liability*

In the trial to foreclose tax liens, the government produced no evidence on the amount of tax liability, but chose instead to rely upon the presumption of cor-

rectness which applied to the assessments of tax. The taxpayers contend that the district court erred in awarding judgment on the basis of the presumption. They argue that the presumption never arose, or was destroyed by the substantial errors in the original assessments.

A. *Factual Foundation for the Assessments*

[1, 2] In an action to collect tax, the government bears the burden of proof. The government can usually carry its initial burden, however, merely by introducing its assessment of tax due. Normally, a presumption of correctness attaches to the assessment, and its introduction establishes a prima facie case. *Welch* v. *Helvering*, 290 U.S. 111, 115, 54 S.Ct. 8, 9, 78 L.Ed. 212 (1933); *United States* v. *Molitor*, 337 F.2d 917, 922 (9th Cir. 1964). The presumption does not arise unless it is supported by a minimal evidentiary foundation. *Weimerskirch* v. *Commissioner*, 596 F.2d 358, 360 (9th Cir. 1979). The taxpayers contend that the assessments here were not entitled to the presumption of correctness because they lacked any factual foundation.

[3, 4] The factual foundation for the assessment is laid "once some substantive evidence is introduced demonstrating that the taxpayer received unreported income." *Edwards* v. *Commissioner*, 680 F.2d 1268, 1270 (9th Cir. 1982) (per curiam). *Accord Weimerskirch* v. *Commissioner*, 596 F.2d 358, 360 (9th Cir.

1979); *United States* v. *Janis*, 428 U.S. 433, 441-42, 96 S.Ct. 3021, 3025-26, 49 L.Ed.2d 1046 (1976); *Suarez* v. *United States*, 582 F.2d 1007, 1010 n. 3 (5th Cir. 1978); *Carson* v. *United States*, 560 F.2d 693, 696-98 (5th Cir. 1977); *Gerardo* v. *Commissioner*, 552 F.2d 549, 552 (3d Cir. 1977). In *Weimerskirch*, the government assessed deficiencies based on allegedly unreported income from the sale of heroin. The government offered no evidence, however, showing that Weimerskirch had ever sold any heroin, or that he had received any unreported income. 596 F.2d at 361-62. This court held that the Commissioner was not entitled to rely solely on the presumption of correctness. Here, in contrast, overwhelming evidence demonstrated that the taxpayers had received millions of dollars of unreported income from their Philippine and American businesses. Between 1959 and 1962, more than nine million dollars flowed into secret Swiss bank accounts belonging to the taxpayers. The taxpayers acquired over four million dollars worth of property and securities in the United States with money from these Swiss accounts. During these years, the taxpayers reported income totalling only $200,000. The assessments thus stood securely upon a foundation of concrete evidence; the presumption of correctness was applicable.

The taxpayers next argue that this foundation evidence was admitted solely on the issue of fraud and cannot be used to support the presumption. This argument too narrowly restricts the ruling of the trial judge. He explained the permissible use of the evi-

dence: "The Government may rely on any evidence to defend the integrity of the Commissioner's determination against the taxpayers' attacks. The Government may not, however, rely on evidence admitted on the issue of fraud to prove specific items of tax liability." 420 F.Supp. at 57 n. 10. The district judge was concerned that the government might abandon its reliance upon the presumption of correctness by trying to prove and total up many individual items of tax liability. The government is not doing that here. To "defend the integrity" of the assessments comprehends supplying the necessary factual basis to show that they are not utterly without foundation. The use of the fraud evidence by the district judge himself reinforces this interpretation. The district judge used the fraud evidence in deciding that the taxpayers' records were inadequate, *id.* at 55 n. 9, and in showing a likely source of of income to justify the use of the net worth method, *id.* We are satisfied that the district court's admission of the fraud evidence was not so restricted as appellants contend, and that it is available to supply the *Weinerskirch* factual foundation.

We conclude the district court properly held that the presumption of correctness applied to the assessments.

B. *Taxpayers' Rebuttal of the Presumption*

The taxpayers contend that they successfully rebutted the presumption of correctness by demonstrating substantial errors in the assessments.

[5] Introduction of the presumptively correct assessment shifts the burden of proof to the taxpayer. *United States* v. *Molitor*, 337 F.2d 917, 922 (9th Cir. 1964). If the taxpayer rebuts the presumption, it disappears. In a suit to collect tax on unreported income, the burden of proving the deficiency then reverts to the government. *Herbert* v. *Commissioner*, 377 F.2d 65, 69 (9th Cir. 1967); 9 Mertens, Law of Federal Income Taxation § 49.218 (1976).

[6-8] To rebut the presumption of correctness, the taxpayer has the burden of proving that the assessment is "arbitrary or erroneous." *Helvering* v. *Taylor*, 293 U.S. 507, 515, 55 S.Ct. 287, 291, 79 L.Ed. 623 (1935); *Cohen* v. *Commissioner*, 266 F.2d 5, 11 (9th Cir. 1959). Where an assessment is based on more than one item, the presumption of correctness attaches to each item. Proof that an item is in error destroys the presumption for that single item; the remaining items retain their presumption of correctness. *Clark* v. *Commissioner*, 266 F.2d 698, 707 (9th Cir. 1959); *Hoffman* v. *Commissioner*, 298 F.2d 784, 788 (3d Cir. 1962); *Foster* v. *Commissioner*, 391 F.2d 727, 735 (4th Cir. 1968); *Anderson* v. *Commissioner*, 250 F.2d 242, 246 (5th Cir. 1957); *Banks* v. *Commissioner*, 322 F.2d 530, 538 (8th Cir. 1968). Even where the assessment has separable items, however, error which demonstrates a pattern of arbitrariness or carelessness will destroy the presumption for the entire assessment. *Hoffman* v. *Commissioner*, 298 F.2d 784, 788 (3rd Cir. 1962). *See Gasper* v. *Commissioner*, 225 F.2d 284 (9th Cir.

1955); *Cohen* v. *Commissioner*, 266 F.2d 5 (9th Cir. 1959); *Thomas* v. *Commissioner*, 223 F.2d 83 (9th Cir. 1955).

[9] Here, two "errors" reduced the assessments by about sixty percent: the pretrial concession that half of the conjugal income was not taxable to the taxpayers, and the trial court's decision that the ten million peso bribe should be treated as a business expenditure.[9] The district court held that the presumption of correctness applied to the remaining parts of the assessment, and that the errors did not show arbitrariness. These factual determinations of the district court will not be overturned unless they are "clearly erroneous." *Weimerskirch* v. *Commissioner*, 596 F.2d 358, 359-60 (9th Cir. 1979).

The taxpayers contend that the "multiple items" doctrine could not apply here, for these assessments contained no separable items but only solitary assertions of tax due in each year. Thus, they say, the errors left no "unaffected parts" to which the presumption could adhere. This argument fails, however, for the parts need not be delineated in the assessment itself. In *Clark* v. *Commissioner*, 266 F.2d 698 (9th Cir. 1959),

9. One other adjustment was made to the assessments. About $700,000 in bribes to various officials were documented in a secret "Blue Book." The State Department feared that publication of the Blue Book would damage United States foreign policy interests. The government therefore agreed to treat the $700,000 as deductible business expenses and the taxpayers agreed not to claim that this change in the assessments made them arbitrary. The district court then sealed the book.

we held that error in one separable item did not infect the entire assessment. The parts in that case were not separately set forth in the assessment itself, but in a report prepared by a government agent. *Id.* at 705 & 707. *Accord, Banks* v. *Commissioner*, 322 F.2d 530, 538 (8th Cir. 1968). Thus, in the present case, the multiple items could be supplied by the net worth calculations underlying the assessments. Reliance upon the net worth computations is complicated by the government's failure to put them into evidence. In this case, however, the taxpayers admit that they received the net worth calculations in their notices of deficiency. They actually attacked several individual items of the calculations, and showed that the Commissioner had erroneously excluded the ten million peso bribe from their opening net worth. Attorneys for both sides, on the record, made repeated references to the net worth calculations and the numerous items of which they were comprised.[10] In these circumstances, the district judge correctly ruled that the assessments were based upon multiple items, and that the presumption continued to apply after the adjustments.

The taxpayers have also failed to prove that the errors demonstrate a pattern of arbitrariness. *Gasper* v. *Commissioner*, 225 F.2d 284 (9th Cir. 1955), presents the kind of pervasive arbitrariness that can taint the entire assessment. There, the Commissioner used

10. The status of the net worth calculations was somewhat unclear. The district judge based portions of his opinion upon them. 420 F.Supp. at 59-61.

the "mark-up" method to determine income for a small pub. The Tax Court found, however, that the number of bottles consumed during the year was known, as were the various prices per drink and number of drinks per bottle. A simple calculation could accurately determine income, yet the Commissioner adopted a method which appeared to bear only a slight relationship to actual income. For one class of liquor the mark-up method overstated income by more than fifty percent. *Id.* at 285. Thus, the method chosen was unnecessarily crude. All of the resulting assessments were infected by this fundamental error; no presumption could survive.

Neither of the errors here shows the arbitrariness displayed in *Gasper*. Whether the taxpayers were taxable on all of their business income or (as ultimately proved to be the case) on only half presented a difficult question of Philippine law. Experts differed. The taxpayers themselves failed to make community property claims on their returns. In these circumstances, the government's pre-trial concession of this unclear legal point does not cast doubt upon the other items underlying the assessment, nor show carelessness. *See Gobins* v. *Commissioner*, 18 T.C. 1159, 1169 (1952), *aff'd per curiam*, 217 F.2d 952 (9th Cir. 1954); *Silverman* v. *Commissioner*, 538 F.2d 927, 930-31 (2d Cir. 1976). The district judge was correct in finding that this error did not destroy the presumption.

Similarly, the Commissioner's classification of the

ten million peso bribe as a personal expenditure, although error, was reasonable. The payment was illegal and was not reflected in the records of any of the taxpayers' corporations. The money apparently came from the taxpayers' personal funds. The mistaken treatment of this payment did not demonstrate a pattern of pervasive arbitrariness that could infect the entire assessment.

[10] These conclusions are buttressed by the nature of this case. The Commissioner was forced to use the imprecise net worth method of estimating income because the taxpayers' records were unreliable and did not accurately reflect income. 420 F.Supp. at 55. Some error is unavoidable in such a reconstruction. *Banks* v. *Commissioner*, 322 F.2d 530, 548 (8th Cir. 1963). Errors arising from the taxpayers' attempts to conceal their income will rarely rebut the overall presumption of correctness. Skillful concealment must not raise an insurmountable barrier to proof. *United States* v. *Johnson*, 319 U.S. 503, 518, 63 S.Ct. 1233, 1240, 87 L.Ed. 1546 (1943).

The district judge was correct in holding that the assessments, after adjustment to reflect necessary changes, continued to carry the presumption of correctness. Because the taxpayers failed to discharge their burden of rebutting the presumption, the tax liability was established.

C. *Other Contentions*

[11, 12] The taxpayers contend that the use of the

net worth method was improper. The net worth method is acceptable only if the taxpayers' records do not accurately reflect income. *Holland* v. *United States*, 348 U.S. 121, 125, 75 S.Ct. 127, 130, 99 L.Ed. 150 (1954). Here, taxpayers caused millions of unrecorded dollars to be deposited in Swiss bank accounts. Any contention that the taxpayer's records accurately reflected income is frivolous. Use of the net worth method here was proper.

[13, 14] The taxpayers next argue that the government may have abandoned the presumption of correctness by switching to a theory of constructive dividends. Such a change of legal theory may destroy the presumption that the assessments were correct. *Helvering* v. *Tex-Penn Oil Co.*, 300 U.S. 481, 57 S.Ct. 569, 81 L.Ed. 755 (1937). The government's constructive dividend theory, however, was not a change from the net worth method, but an integral part of it. Some of the money from the Swiss accounts was used to pay expenses of USTC in America. In calculating the taxpayers' closing net worth, the government treated these payments as capital contributions to USTC, and therefore as evidence of taxable income. The taxpayers attacked this allocation, arguing that the money represented USTC earnings in the Philippines used to pay USTC expenses in the United States. Thus, the taxpayers argued that these increases in net worth were not yet taxable to them. *See United States v. Smith*, 418 F.2d 589, 593 (5th Cir. 1969); *Ireland* v. *United States*, 621 F.2d 731 (5th Cir. 1980) (a constructive

dividend must advance the shareholder's personal, not business interest). The government replied that while in the Swiss accounts, the money was under the sole control of the taxpayers. The money thus amounted to constructive dividends to them from their corporations, and was income. *Corliss* v. *Bowers*, 281 U.S. 376, 378, 50 S.Ct. 336, 336, 74 L.Ed. 916 (1930); *Hartman* v. *United States*, 245 F.2d 349, 352-53 (8th Cir. 1957). So employed, the constructive dividend theory was merely an underlying part of the government's net worth case. Reliance on this sub-theory does not defeat the presumption.

The taxpayers also complain that, although they were ready to attack specific items of the net worth computations, they were unable to do so because the figures were never put into evidence. The absence of these calculations, they contend, made it unfairly difficult for them to carry their burden of proving the assessment arbitray or erroneous.

The taxpayers' protestations of unfairness, however, fly in the face of the record. The taxpayers admit that they received notices of deficiency which set forth the net worth calculations. The taxpayers deposed a government agent regarding the net worth statements and in 1972 received detailed requests for admissions concerning the net worth computations. Their own counsel repeatedly referred to the large number of items comprised in the calculations. Finally, the taxpayers actually attacked several individual elements of

the net worth calculations: the cash on hand in the opening net worth, the government's failure to include the ten million peso payment as an asset in their opening net worth, the original value of stock in USTC, and the inclusion in the closing net worth of payments from the Swiss accounts for the benefit of USTC in the United States. The district court agreed with their argument concerning the ten million peso payment. 420 F.Supp. at 59.

[15] Fairness may indeed require that the taxpayer know the basis for an assessment. We certainly do not recommend that the government refrain from putting its net worth computations into evidence. Nevertheless, the taxpayers here knew each detail of the calculations. Under these circumstances, no substantial unfairness resulted from the failure to introduce the computations into evidence.

[16] Finally, the taxpayers argue that the judgment assumes certain matters that are not supported by the record: for example, the amount of long-term capital gain, the amount of dividends received credit, and whether the ten million peso bribe was made with separate or community property funds. This argument is not well-founded. The asumptions of capital gains and dividends credit were used in making the assessment and so are presumptively correct. The taxpayers have not carried the burden of proving them wrong. The fifty-fifty split made by the district court in allocating the community property interest was reasonable in the

absence of other indications; the taxpayers have not shown it to be incorrect. The judgment thus rests securely on the prima facie case created by the assessments.

We therefore hold that the presumption of correctness applied to those assessments and was not rebutted. The judgment of tax liability is accordingly affirmed.

## II. *Community Property Interests*

The realty covered by the government's tax liens is community property. The parties agree that the nature and extent of the husband's interests in the properties is governed by Philippine law. Taxpayers' wives contend that under Philippine law and the Internal Revenue Code the tax liens cannot apply to more than their husbands' half interests in the property. The district court rejected this argument and the wives appeal.

[17] Under Philippine law, income from the husbands' businesses was conjugal property[11] in which the wife had an immediate vested half interest. Philippine Civil Code Ann. Art. 153 (1971). The taxpayers are taxable only on their half of the community income. Rev.Rul. 269, 1956-1 C.B. 318; *United States v. Mitchell*, 403 U.S. 190, 197, 91 S.Ct. 1763, 1768, 29 L.Ed. 2d 406 (1971). The wives are neither citizens nor residents of the United States and so are not subject to United States income tax.

11. Philippine law uses the term "conjugal property" instead of community property. For our purposes, they have the same meaning.

[18] The government concedes that it cannot tax the wives on their half of the conjugal income. The issue here is whether tax liens arising from properly assessed deficiencies on the husbands' half of the income can be foreclosed against all of the conjugal property.

[19] Philippine law provides that the conjugal property is liable for certain debts of the husband. Article 161 of the Philippine Code provides: "The conjugal partnership shall be liable for (1) all debts and obligations contracted by the husband for the benefit of the conjugal partnership . . ." Generally, obligations incurred in the course of a trade or business are for the benefit of the community. *Luzon Surety Co.* v. *De-Garcia*, 30 S.C.R.A. 111, 115 (Phil. 1969). In certain unusual circumstances, where the community received no actual benefit, business obligations have been held to fall beyond the scope of Article 161. *Id.* (husband received no consideration for standing as surety on a debt); *Laperal v. Katigbak*, 104 Phil. 999, 1004-05 (1958) (spouses separated and wife no longer received any of the business income). Here, the wives undeniably received the benefits of their husbands' business income; the tax obligations were incurred to benefit the community.

The wives argue that, although they received income from their husbands' businesses, they received no benefit from the attachment of the tax liens. This argument ignores the reality of this transaction. The

income and tax were not two unrelated transactions; rather they are aspects of a single transaction. The wives can no more retain the benefit of earnings while avoiding the non-beneficial taxes than they could retain a loan while avoiding the non-beneficial obligation of a promissory note. *See Laperal* v. *Katigbak*, 104 Phil. at 1004; *Javier* v. *Osmena*, 34 Phil. 336 (1916).

Second, the wives contend that their husbands lack any property interest in the wives' half of the property to which the tax liens can attach.

[20] Pursuant to 26 U.S.C. § 6321 (1967), a lien for unpaid taxes arises upon "all property and rights to property, whether real or personal, belonging to such person."[12] Local law, here Philippine, determines whether the taxpayer has "rights to property" to which the tax lien may attach. *See Morgan* v. *Commissioner*, 309 U.S. 78, 80, 60 S.Ct. 424, 425, 84 L.Ed. 585 (1940); *Runkel* v. *United States*, 527 F.2d 914 (9th Cir. 1975). Because the tax deficiencies were assessed only against the husbands, the tax liens under Section 6321 can encumber only property in which the husbands have some right. The wives contend that their

12. 26 U.S.C. § 6321 provides:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

husbands have no property rights in the wives' half of the conjugal property, and that the tax liens therefore cannot extend to more than the husbands' half of the conjugal properties.

For support, the wives cite *United States* v. *Overman*, 424 F.2d 1142 (9th Cir. 1970); *Ackerman* v. *United States*, 424 F.2d 1148 (9th Cir. 1970), and *Commissioner* v. *Cadwallader*, 127 F.2d 547 (9th Cir. 1942). None of these cases, however, is controlling.

In both *Overman* and *Ackerman*, state law prevented a husband's premarital creditors from reaching any of the community property. The government nevertheless attempted to foreclose premarital tax liens against the community property. The wives argued that the husbands lacked a separate property interest in any of the community property to which a premarital tax lien could attach. *Overman*, 424 F.2d at 1145; *Ackerman*, 424 F.2d at 1149. We held that § 6321 overrode the state creditor exclusion and that the husband had a sufficient property right in his undivided one half interest in the community property for the assertion of tax liens. *Overman*, 424 F.2d at 1146; *Ackerman*, 424 F.2d at 1150.

Thus, *Overman* and *Ackerman* extended the reach of premarital tax liens to half of the community property even when state law insulated the community property from premarital creditors generally. In the present case, in contrast, Philippine law (Article 161) permits the liens to reach *all* of the conjugal property.

Nothing in *Overman* or *Ackerman* reduces the reach of the tax liens below what local law permits.

In *Commissioner* v. *Cadwallader*, 127 F.2d 547 (9th Cir. 1942), we considered the application of federal estate taxes to an American couple living in the Philippines. When the husband died, we held that "for the purpose of the federal estate tax the husband must be held to have no interest in the wife's share of the conjugal estate." *Id.* at 549-50. Thus, the assessment of estate tax was limited to his half of the community property. Similarly, here, income tax was assessed on only half of the community income. *Cadwallader* does not control on the issue of whether the husband has a property interest in the conjugal property for purposes of section 6321.

We faced this issue squarely in *Babb* v. *Schmidt*, 496 F.2d 957 (9th Cir. 1974). There, California law made the community property liable for the husband's separate debts. The government tried to foreclose premarital income tax liens against all of the community property. Relying upon *Overman* and *Ackerman*, the wife argued that her husband had no property right in her half of the community property to which a tax lien could attach. We rejected her contention: "If California law makes the wife's share of the community property available to creditors of the husband, California law has by the same rule implicitly given the husband rights in that property sufficient to meet the requirements of 26 U.S.C. § 6321." *Id.* at 960.

The present situation is indistinguishable. Article 161 gives certain of the husband's creditors rights against the conjugal property. Under the holding of *Babb* v. *Schmidt*, this is a sufficient property interest to support the tax liens. *Accord United States v. Rexach, F. V.*, 77-1 U.S.T.C. ¶ 9105 (D.P.R. 1977); *United States* v. *Benitz Rexach*, 411 F.Supp. 1288 (D.P.R. 1976) rev'd on other grounds, *United States* v. *Lucienne D'Hotelle*, 558 F.2d 37 (1st Cir. 1976) (the tax liens imposed on the community property, but tax liability so secured did not exceed half of community assets).

The district court was therefore correct in deciding that the tax liens encumbered all of the conjugal property.

## III. *Liens for Attorney's Fees*

TRNL appeals the district court's ruling that any rights TRNL has in these properties are subordinate to the government's tax liens.

On January 25, 1965, the United States filed notices of tax liens and notices of pendency of action covering all of the property subject to this suit. Shortly thereafter, the taxpayers employed TRNL to defend them in the ensuing litigation.

On April 8, 1965, the taxpayers and the United States executed a stipulation regarding the property

subject to the tax liens. Paragraph four of the stipulation provides:

> (a) Upon the approval hereof by the Court this stipulation shall constitute an order of the Court effective forthwith and restraining defendant Harry S. Stonehill, his agents, employees and attorneys, from in any manner, either directly or indirectly, selling, mortgaging, pledging, encumbering, assigning, or otherwise disposing of, or withdrawing or removing all or part of the properties or assets which he owns in the United States, including, but not limited to those listed in the attached Schedule A, from the jurisdiction of this Court or from the jurisdiction of the United States District Court for the Northern District of California or from the jurisdiction of the United States District Court for the District of Hawaii (as the case may be) or from the territorial confines of the United States.

Attorneys from TRNL signed the stipulation on behalf of the taxpayers.[13]

By 1977, the taxpayers owed TRNL some $800,000

13. Hans Nathan, a partner in TRNL, later explained the stipulation:

> I personally negotiated and reached an understanding with opposing counsel to the effect that, to effect an orderly disposition of this case without causing any prejudice to the United States, the Defendant would be permitted to obtain funds from sources abroad; to expend these funds freely to defray his living expenses and for the expenses of this suit during the pendency thereof. Defendant in turn would not attempt to dispose of any assets located in the United States at the time of the entering into of said agreement. The agreement was implemented by a stipulation and order dated April 9, 1965 and filed herein.

in legal fees. To satisfy this obligation, the taxpayers executed trust deeds conveying security interests in certain California properties to TRNL. The law firm filed the deeds in the records of Marin County, California. The properties were already the subject of this litigation.

TRNL asserts that it has liens on these properties, either because of the trust deeds or because of equitable liens for attorney's fees arising under California law. TRNL also argues that its rights have priority over the government's tax liens.

[21] The government's properly filed tax liens normally would take priority over the subsequent rights of TRNL. 26 U.S.C. § 6321. To retain the original priority longer than six years, however, 26 U.S.C. § 6323(g) requires the government to refile its notice of tax lien. Here the government failed to refile within the statutory period. Although the failure to refile does not affect the validity of the liens, it may reduce their priority. S.Rep. No. 1708, 89th Cong., 2d Sess. (Sen.Fin. Comm.) *reprinted* in 1966 U.S. Code Cong & Admin. News 3722, 3733. Treasury Regulation 26 C.F.R. 301. 6323(g)-1, however, creates an exception to the refiling requirement for property "which is the subject matter of a suit to which the United States is a party, commenced prior to the expiration of the required refiling period." TRNL contends that the regulation is invalid because it is contrary to the legislative intent of the statute it purports to interpret. Because of our

resolution of TRNL's claims, we need not reach this issue.[14]

A. *The Deeds of Trust*

[22, 23] Generally, a client may by agreement grant his attorney a lien to secure legal fees. *Isrin* v. *Superior Court*, 63 Cal.2d 153, 403 P.2d 728, 45 Cal.Rptr. 320 (1965); *Norman* v. *Berney*, 235 Cal.App.2d 424, 45 Cal.Rptr. 467 (1965); *Wagner* v. *Sariotti*, 56 Cal.App. 2d 693, 133 P.2d 430 (1943). Here, however, the district judge ruled that the deeds of trust conveyed no valid security interest because they violated the court order. TRNL argues that this ruling was error. By affidavit, TRNL states that the stipulation was not intended to apply to attorney's fees, but was only to prohibit assignment to foreign entities.

TRNL's interpretation ignores the plain wording of the order. The order prohibits "in any manner, either directly or indirectly, selling, mortgaging, pledging, encumbering" the property subject to tax liens. This language is unambiguous. TRNL's own 1969 explication of the meaning of the order is in accord. *See* note 13 *supra*. The district court did not err in finding that the attempted conveyance violated the order.

14. The government argues that regardless of the validity of the treasury regulation the tax liens take priority under the California law of *lis pendens*. We note that the special filing procedures for tax liens may preclude reliance upon state *lis pendens* rules to protect tax liens. Again, however, in view of our disposition of TRNL's claims, we need not decide this issue.

Nor did the district judge err in holding that the deeds of trust could convey to TRNL no interest superior to the tax liens. TRNL was present at the negotiation and signing of the stipulation. The attempted conveyance treads dangerously close to wilful violation of a court order. A federal court's general equitable and disciplinary powers suffice to invalidate the deeds of trust under these circumstances. *See Lamb* v. *Cramer*, 285 U.S. 217, 52 S.Ct. 315, 76 L.Ed. 715 (1932). Any rights of TRNL arising by agreement with the taxpayers are junior to the government's tax liens.

[24] TRNL also asserts equitable liens for attorney's fees arising by operation of California law. California law provides an equitable lien for attorneys in only two situations: the creation of a "common fund" or the maintenance of litigation which produces "substantial benefits" for a class. *Mandel* v. *Hodges*, 54 Cal.App.3d 596, 620, 127 Cal.Rptr. 244, 260 (1976); *Fletcher* v. *A. J. Industries, Inc.*, 266 Cal. App.2d 313, 320, 72 Cal.Rptr. 146 (1968). TRNL contends that by substantially reducing the assessment it "protected and preserved" a fund, and thus falls within the "common fund" doctrine under the holding of *Winslow* v. *Harold G. Ferguson Corp.*, 25 Cal.2d 274, 153 P.2d 714 (1944).

In *Winslow*, a lawyer represented some beneficiaries of a trust. The trust purpose had become impossible to achieve and all the beneficiaries were in danger of losing the value of their interests. The lawyer

succeeded in terminating the trust and securing the appointment of a receiver to liquidate the trust assets and distribute them to the beneficiaries and creditors. 153 P.2d at 716. The California Supreme Court stated:

> It is a well-established doctrine of equity jurisprudence that where a common fund exists to which a number of persons are entitled and in their interest successful litigation is maintained for its preservation and protection, an allowance of counsel fees may properly be made from such fund. By this means all of the beneficiaries of the fund pay their share of the expense necessary to make it available to them.

*Id.* 153 P.2d at 715. In *Winslow*, the United States was one of the creditors. The court held that an equitable lien arose upon the trust assets for the attorney's fees and took precedence even over pre-existing tax liens. The court commented: "Counsel's right to compensation under such circumstances arises from the benefit conferred upon those who would have suffered loss but for his timely intervention, and not by reason of an agreement to pay his fees." *Id.* 153 P.2d at 719.

The situation at hand is very different from *Winslow*. In *Winslow*, the United States was one of a class of creditors who benefited from the lawyers' efforts in protecting the common fund from dissipation. Here, in contrast, no "common fund" existed. TRNL did not "preserve" a fund for the benefit of the United States. Its efforts, in fact, were directed toward defeating the government's claims. TRNL's reliance upon *Winslow*

thus is misplaced. No lien arises in these circumstances. For the same reason the following cases cited by TRNL are inapposite: *Kennebec Box* v. *O. S. Richards Corp.*, 5 F.2d 951 (2d Cir. 1925); *In re Holmes Manufacturing Co.*, 19 F.2d 239 (2d Cir. 1927); *In re Columbia Ribbon Co.*, 117 F.2d 999 (3d Cir. 1941); *Bauer & Son* v. *Wilkes-Barre Light Co.*, 274 Pa. 165, 117 A. 920 (1922), and *Malm* v. *Home Riverside Coal Mines Co.*, 152 Kan. 419, 103 P.2d 798 (1940).

Finally, TRNL argues that *Mackall* v. *Willoughby*, 167 U.S. 681, 17 S.Ct. 954, 42 L.Ed. 323 (1897), supports its claim to an equitable lien. *Mackall*, however, is not on point. In *Mackall*, the attorney and client had a *written fee* agreement. The dispute involved the proper construction of their word "recovered" as used in the contract. *Mackall* provides no benefit for a party asserting non-contractual liens.

Thus, California law provides no equitable lien in favor of TRNL. Because the trust deeds conveyed no interest, the district court correctly ruled that TRNL has no interest in any of the properties subject to the government's tax liens.

## IV. *Other Appellants*

[25] Appellants Ben Gromet, William W. Saunders, Tower Development Corporation, and Meriwether Development Corporation claim interests in certain properties involved in this suit. These appellants stipulated that the validity of the tax liens should be tried before

determination of their respective rights in the property. The district court's order purported to dispose of the interests of all parties, although it did not expressly consider the claims of these appellants.

These appellants have not yet had their day in court. The judgment, insofar as it pertains to them, is reversed and remanded to the district court for determination of their claims.

## CONCLUSION

The judgment insofar as it relates to Ben Gromet, William W. Saunders, Tower Development Corporation and Meriwether Development Corporation is reversed and remanded for resolution of their claims. The judgment as it relates to all other appellants is affirmed.

AFFIRMED in part; REVERSED in part and REMANDED.

**APPENDIX B**

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

**FILED**
SEP 01 1983
PHILLIP B. WINBERRY
CLERK, U.S. COURT OF APPEALS

| | | |
|---|---|---|
| UNITED STATES OF AMERICA, | ) | |
| | ) | |
| *Plaintiff-Appellee,* | ) | |
| | ) | |
| HARRY S. STONEHILL, Individually | ) | No. CA 80-4590 |
| and as Trustee of the Lourdes | ) | 80-4598 |
| Blanco Stonehill Children's Trust, | ) | 80-4599 |
| The Elizabeth Anne Stonehill Trust, | ) | 80-6062 |
| and The Susan J. Stonehill Trust, et al., | ) | D.C. |
| *Defendants-Appellants,* | ) | |
| | ) | |
| TRAMMEL, RAND, NATHAN & | ) | No. 65-127-GJS |
| LINCOLN, a Partnership; AND | ) | 43244-SW |
| PACITA CARRION BROOKS, | ) | 2348 |
| | ) | ORDER |
| *Intervenors-Appellants.* | ) | |

BEFORE: CANBY, NORRIS and REINHARDT, Circuit Judges.

A majority of the panel as constituted in the above case has voted to deny the petition for rehearing and to reject the suggestion for a rehearing en banc.

The full court has been advised of the suggestion for an en banc rehearing, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

## APPENDIX C

UNITED STATES of America, *Plaintiff*,

v.

HARRY S. STONEHILL et al., *Defendants*.

Civ. No. 65-127-GJS

United States District Court,
C. D. California.

July 23, 1976.

420 F. Supp 46 (C. D. Cal. 1976)

[Headnotes deleted]

### OPINION

SOLOMON, District Judge.

#### I. *Preliminary Statement*

This is an action to foreclose federal tax liens of about $25 million.

Defendants Harry S. Stonehill and Robert P. Brooks (the taxpayers) are United States citizens who settled in the Philippines after World War II. They became successful and powerful businessmen. They owned, were officers of, or controlled many business organizations and were active in Philippine politics.

About 1960, both Philippine and United States officials became interested in the taxpayers' activities. On March 3, 1962, about 200 agents of the Philippine

National Bureau of Investigation (the NBI) raided the offices of the taxpayers and the offices of 17 companies which they controlled. The NBI took about 35 truckloads of documents.

Agents of the United States Internal Revenue Service (the IRS) spent months examining these documents. On January 18, 1965, the Commissioner of the IRS assessed income tax deficiencies for the tax years 1958 through 1961 against defendant Stonehill of $13,613,721.51 and against defendant Brooks of $11,182,966.73.

On January 25, 1965, the United States filed this action to foreclose tax liens on certain property owned by the taxpayers in this district. Similar foreclosure actions were filed in the Northern District of California [1] and in the District of Hawaii [2]. In an order dated April 9, 1965, the United States and the taxpayers stipulated that, when all opportunities for appeal have been exhausted, the judgment of this Court shall be entered as the judgment in the other two cases.

Thirteen years after the Philippine raids, this case was finally tried on the merits. The parties engaged in extensive discovery; they followed leads and gathered evidence in the Philippines, the United States, Canada, Belgium, Luxembourg, Switzerland, Japan, and Hong Kong. The parties vigorously litigated the taxpayers' charges that the Government illegally seized

1. Civil Action No. 43244.
2. Civil Action No. 2348.

certain evidence. The taxpayers' motion to suppress was denied by the trial court, and in 1968 the Ninth Circuit Court of Appeals affirmed; the Supreme Court denied certiorari. The taxpayers renewed the motion to suppress several times.

Lawyers, accountants, and investigators for both the Government and the taxpayers have spent years working on this case, and the parties have spent many hundreds of thousands of dollars prosecuting and defending it. There have been more than 35 separate court sessions. In 1972, I became the third judge assigned to the case.

The decision of this case has been complicated by the complexity of the taxpayers' financial transactions and business entities, by the non-existence or unavailability of crucial records and documents, by the unavailability or noncooperation of important witnesses, including Stonehill and Brooks who refused to appear, and by sensitive political and diplomatic considerations.

These difficulties have been compounded by numerous allegations of misconduct asserted by the Government against the taxpayers and by the taxpayers against the Government at all levels. The Government alleges that the taxpayers made fortunes through illegal business activities, fraudulently concealed millions of dollars in income, bribed high Philippine officials, and sometimes resorted to gangland tactics to deal with their enemies.

The taxpayers allege that the Government, through the Justice Department, the State Department, the IRS, the Federal Bureau of Investigation (the FBI) and the Central Intelligence Agency (the CIA), conspired with Philippine officials to ruin them financially and to force them to leave the Philippines. The taxpayers further allege that the Government illegally seized and stole their records, spread false and malicious rumors about them, caused them to be arrested and deported from the Philippines and excluded from other foreign countries, planted a Government informer in their business, illegally tapped their telephones, and deliberately concealed evidence favorable to them.

## II. *Motion to Suppress*

In March 1967, the taxpayers filed a motion to suppress. In October 1967, after a nine-day hearing on this motion, District Judge Westover denied it. 274 F.Supp. 420 (S.D.Cal.). His interlocutory order of denial was appealed under 28 U.S.C. § 1292(b). The Ninth Circuit Court of Appeals affirmed. 405 F.2d 738 (1968), *rehearing denied*, 405 F.2d 738 (1969), *cert. denied*, 395 U.S. 960, 89 S.Ct. 2102, 23 L.Ed.2d 747, *rehearing denied*, 396 U.S. 870, 90 S.Ct. 39, 24 L.Ed.2d 125.

The Court of Appeals held that, although the 1962 raids were illegal under both United States and Philippine law, the evidence seized in those raids was admissible because it was handed to United States officials on

a "silver platter". After setting forth the role that United States officials played in the raids, the Court concluded that the United States officials did not instigate or direct or significantly participate in the raids by Philippine officials. The case was remanded to the district court for trial on the merits.

In February 1971, the taxpayers filed a "Renewed Motion to Suppress Evidence" based on newly discovered evidence. On May 26, 1971, Judge Westover denied the renewed motion.

In August 1971, the taxpayers filed a "Motion for Reconsideration of Order Dated May 26, 1971". In November 1971, Judge Westover, after oral argument, denied the motion because the new evidence was "merely cumulative of evidence previously offered" and raised "no new significant evidence in support of . . . [the taxpayers'] position".

In May 1975, the taxpayers renewed their motion to suppress, which is now before the Court. They contend that new evidence discovered since the 1968 Court of Appeals' decision requires suppression of the evidence seized in the 1962 raids. In addition, the taxpayers seek to suppress evidence which they contend was "obtained by other illegal acts and methods" such as "wiretapping and theft of documents".

[1] The threshold question here is whether the taxpayers may renew their motion to suppress after the Court of Appeals affirmed the denial of their earlier motion. I hold that they may.

[2] The doctrine of res judicata does not apply to an interlocutory order, such as a motion to suppress, even if the order was affirmed on appeal. *Pennsylvania Turnpike Commission* v. *McGinnes*, 169 F.Supp. 580 (E.D.Pa.1958). The appellate decision does, however, become the "law of the case". As the Eighth Circuit said in *Toucey* v. *New York Life Insurance Co.*, 112 F.2d 927, 928 (1940):

> "A decision of an appellate court is, as to the legal issues considered and determined, the law of the case in any subsequent proceedings in either the trial or the appellate court, and is to be followed except where the evidence is substantially different, or where, between the date of the decision and the time of the reconsideration of the case, controlling authority has determined the legal issues adversely, or where it appears that the decision was clearly erroneous and that adherence to it will work a manifest injustice."

The Court of Appeals' opinion on the taxpayers' original motion to suppress adequately sets forth the evidence before that court. I shall not repeat that evidence here.

A. *Renewal of Motion to Suppress Raid Documents*

The taxpayers contend that since that decision they have discovered new evidence which proves that United States officials instigated and directed the 1962 raids.[3]

3. The taxpayers' newly discovered evidence does not relate to the physical participation by United States officials in the raids.

They therefore contend that the evidence seized in those raids should be suppressed.

[3] Because the 1968 Court of Appeals' decision is the law of this case, the taxpayers can prevail only if they show that the newly discovered evidence, when considered with the total record, materially changes the evidence in support of their position.

The taxpayers contend that their new evidence shows that United States officials were actively investigating the taxpayers much earlier than the previous evidence showed. They also contend that the Philippine authorities who conducted the raids were acting at the instigation and direction of United States officials.

Contrary to these contentions, I find that United States officials were interested in the taxpayers' activities before Menhart Spielman talked to FBI agent Hawley in December 1961, but that these officials did not conduct an active investigation. But even an active investigation before December 1961 does not prove that the United States officials had anything to do with the raids.

Furthermore, even if they did actively investigate the taxpayers before December 1961, that does not materially add to the evidence before Judge Westover in 1967. By January 1962, more than a month before the raids, the officials decided to actively investigate the taxpayers. The court nevertheless concluded that the

NBI conducted the raids for its own purposes and not for the United States.

The only direct evidence to support the taxpayers' contention that United States officials instigated, conducted or participated in the raids is the trial testimony of Damaso Nocon, a former aide to Colonel Jose Lukban, Director of the NBI. Nocon's testimony is directly contrary to the testimony of Lukban, IRS agent Robert Chandler and FBI agent Hawley. Each of them testified that the NBI did not conduct the raids for the United States or with the help of the United States.

I find that Nocon's testimony is not credible. I believe that the NBI conducted the raids for its own reasons. In 1959-60, several years before the raids, the NBI began to investigate the taxpayers and several other prominent foreign businessmen at the request of a Philippine senator. Antonio Jocom, an NBI agent, was assigned the Stonehill investigation. The object of the investigation was to deport the taxpayers because they allegedly had a corrupting influence on Philippine politics.

As part of the investigation, the NBI wiretapped the taxpayers' telephones in early 1960. During the next two years, the NBI gathered substantial information, and, when Spielman began to cooperate with the NBI in January 1962, the NBI planned the raids which took place on March 3, 1962.

[4] United States officials were interested in the fruits of those raids, but I find that they neither instigated nor directed them. The motion to suppress this evidence is denied.

### B. *Suppression of Evidence from Wiretaps and "Thefts" of Documents*

The taxpayers contend that all of the Government's evidence should be suppressed because it came, directly or indirectly, from illegal wiretaps and thefts of documents. This argument, not previously urged, is based on newly discovered evidence.

The taxpayers contend that the NBI wiretapped their telephones at the request of the United States, that those wiretaps were illegal, and that all of the evidence subsequently gathered by the United States is the fruit of that illegal activity.

NBI Director Lukban testified that the NBI installed the wiretaps in the course of its own investigation of the taxpayers, without any input from the United States. FBI agent Robert Hawley, who was given some transcripts by the NBI, testified that he never asked for wiretaps or transcripts.

The only evidence which supports the taxpayers' position is the testimony of Damaso Nocon, Lukban's aide. As I said earlier, I do not believe Nocon's testimony.

The taxpayers next contend that the United States,

through Menhart Spielman, unlawfully took documents from them, and that all of the evidence subsequently gathered by the United States is the fruit of that illegal activity.

Spielman worked for the taxpayers for about two years. In March 1961, he became Executive Vice President and General Manager of United States Tobacco Corporation, one of the taxpayers' principal companies. During the fall of 1961, both taxpayers were out of the country because of controversy over their role in the on-going Philippine election campaign.

In the taxpayers' absence, Spielman secretly copied some of their records which he thought showed illegal activities. When the taxpayers returned after the election, they and Spielman quarreled; they fired Spielman. It was then that Spielman went to United States officials, told them about the taxpayers' activities, and gave them copies of many documents.

The taxpayers contend that the United States had placed Spielman in the taxpayers' business as an informer and that the documents were therefore illegally obtained.

The taxpayers' evidence, both old and new, fails to prove that Spielman was an agent of the United States when he copied the documents. I find that Spielman copied these records to force the taxpayers to give him part ownership in their business enterprises. When Spielman proposed this, they first beat him and then fired him.

Spielman became fearful of what else they might do to him, so he went to United States officials for protection and for vengeance. He also hoped to receive a reward from the United States for providing information leading to substantial income tax revenue. When United States officials became interested in his revelations, Spielman tried to bargain to get the United States Army to forgive him for his misdeeds while stationed in Tokyo.

[5] The taxpayers failed to show that their telephones were tapped at the request of the United States or that Spielman was an agent of the United States when he copied the documents. Their motion to suppress is denied.[4]

## III. *Taxpayers' Due Process Motion*

The taxpayers seek a "dismissal of Plaintiff's ("Government") complaint and for judgment quashing the purported assessments and liens sought to be foreclosed" on the ground that the Government denied them due process.

When NBI agents raided the taxpayers' business premises on March 3, 1962, they seized about 35 truckloads of documents. The NBI permitted IRS agents, who were investigating the taxpayers, to copy some of those documents. During discovery in this action, the

4. *See also Stone v. Powell*, — U.S. — , 96 S.Ct. 3037, 49 L.Ed.2d —, decided July 6, 1976.

Government gave the taxpayers copies of all of its copies.[5]

The taxpayers contend that the IRS agents copied only documents which tended to support the Government's case and intentionally suppressed documents favorable to the taxpayers.

The NBI seized these records, and more than 20 NBI agents cataloged them. Although the records were under the NBI's exclusive control, it permitted IRS agents to set up a microfilm machine in the house in which the records were kept. The NBI did not, however, give the IRS agents unrestricted access to the records. The IRS agents were allowed to examine and copy only those documents which they requested and which the NBI thereafter brought to them.[6]

The IRS agents testified that they repeatedly asked the NBI agents to bring them all financial records on the taxpayers and their companies. The IRS agents "specifically" mentioned bank accounts, money transfers, assets, liabilities, loans, investment and ownership in corporate and other entities." The IRS agents testified that they copied all relevant financial records

5. These documents given to the taxpayers by the Government are the only access that the taxpayers have had to most of their records since they were seized. The NBI kept most of the records and has not allowed the taxpayer to see them.

6. The IRS agents worked 12 hours a day, seven days a week, for about two and a half months, copying more than 30,000 documents.

brought to them[7] without regard to whom they favored.[8] I believe that testimony.

[6] I find that the taxpayers failed to prove that the Government intentionally suppressed any relevant documents. Their motion is denied.

## IV. *Tax Liability*

The Government contends that the taxpayers increased their combined net worth by almost $16 million during the tax years 1958 through 1961. During that period, taxpayers reported combined incomes of less than $200,000. Using these net worth figures, the Government, in January 1965, assessed the taxpayers more than $14,000,000 in unpaid taxes, more than $7,000,000 in fraud penalties, and more than $3,000,000 in interest.

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7. The IRS agents undoubtedly did not receive every relevant document seized in the raids; millions of documents had to be processed hurriedly by a large number of people because the taxpayers were expected to enjoin the examination of the records. The taxpayers did obtain an injunction a few weeks after the IRS finished most of its copying.

8. Agent Ragland testified: "During the copying process we did not have any idea of what was significant to the audit, and therefore, we were expansive in copying the documents. At this juncture we did not have sufficient knowledge to exclude any financial documents. For instance, a personal financial document indicating a liability could lead to a significant asset and additional income. Also any large asset or liability appearing in any previous year could lead us to sources of more income includible in the tax years under examination."

The taxpayers contend that the assessment is wrong and that they owe no taxes.

[7-9] In an action to collect taxes, the Government has the burden to prove the existence and amount of tax deficiency. *United States* v. *Molitor*, 337 F.2d 917, 922 (9th Cir. 1964). To meet this burden initially, the Government may introduce the notice of assessment. The assessment is presumed to be correct, and the admission of the notice of assessment establishes a prima facie case. *United States* v. *Rindskopf*, 105 U.S. 418, 422, 26 L.Ed. 1131 (1881); *United States* v. *Molitor*, *supra* at 922-23.

A. *The Government's Prima Facie Case*

The taxpayers contend that the Government failed to make a prima facie case.

They contend that the assessments, which underlie the Government's prima facie case, are improperly based on the net worth method. They contend that the Government may use net worth only if the taxpayers' records are either inadequate or do not accurately reflect the taxpayers' income. This, they assert, the Government failed to show.

[10] This contention is frivolous. The taxpayers' records available to the Government are incomplete and do not accurately reflect the taxpayers' income.[9]

The taxpayers next contend that the Government

9. See the discussion in this opinion on the fraud issue.

did not make a prima facie case because it did not introduce in evidence the notices of deficiency.

Generally, the Government begins its tax collection process by sending the taxpayer a notice of deficiency which shows the basis and the amount of tax due. 26 U.S.C. § 6212(a). But, when the "assessment or collection of a deficiency . . . will be jeopardized by delay", the Government may make a jeopardy assessment by sending notice of assessment (also called a collection notice) under 26 U.S.C. § 6303 before sending the notice of deficiency. 26 U.S.C. § 6861(a). When the Government makes a jeopardy assessment, it must also send a Section 6212(a) notice of deficiency "within 60 days after the making of the assessment". 26 U.S.C. § 6861(b).

Here, the Government initiated its collection process by issuing jeopardy assessments. At the trial, the Government introduced the notices of assessment to establish its prima facie case but did not introduce notices of deficiency.

[11] The taxpayers contend that the Government is not entitled to the presumption of correctness and did not make a prima facie case because it did not prove that it sent the notices of deficiency as required by Section 6861(b). The taxpayers rely on *United States* v. *Ball*, 326 F.2d 898 (4th Cir. 1964). There, the court held that a jeopardy assessment under Section 6861(a) is not valid without both a Section 6303 notice of assessment and a Section 6212 notice of deficiency. The

court held that the jeopardy assessment was invalid because the Government failed to prove it set the notice of deficiency.

[12] I do not believe that failure to introduce the notice of deficiency is fatal to a jeopardy assessment. In *Boren* v. *Riddell*, 241 F.2d 670, 672 (9th Cir. 1957), the court held that technical compliance with the Section 6212(a) notice requirement is not necessary if the taxpayer receives actual notice. Here, there was actual notice. The taxpayers acknowledged, at hearings and in their briefs, that they received the deficiency notices. In 1965, the taxpayers, in their petitions to the Tax Court, acknowledged receipt of the notices of deficiency. Furthermore, the Ninth Circuit Court of Appeals has stated that in a jeopardy assessment case the only purpose of the notice of deficiency is to start the time running within which the taxpayers can petition the Tax Court; even an improper notice of deficiency does not render the underlying jeopardy assessment invalid. *Cohen* v. *United States*, 297 F.2d 760, 773 (1962).

I therefore hold that the Government has made a prima facie case.

### B. *The Taxpayers' Burden*

The Government contends that the taxpayers have the burden to prove that the Commissioner's determination of tax deficiency is erroneous and that the burden is on the taxpayers to prove that they owe no taxes.

The taxpayers, on the other hand, contend that their only burden is to prove that the Commissioner's determination is significantly incorrect. The taxpayers also contend that when they do that, the Government may no longer rely on the presumption of correctness, but must prove the existence and amount of tax deficiency.

There appears to be a conflict in the cases on burdens of proof, but the conflict is more apparent than real and results from imprecise language in the opinions. I believe that the cases are generally reconcilable and that the correct rule and the proper procedures are set forth in Mertens, Law of Federal Income Taxation:

> In an action by the Government for the collection of a tax, the burden of proof is upon the United States under the familiar rule that he who alleges, must prove. This burden is initially met, however, merely by proof that the tax liability has been assessed against the defendant; and this is usually done by introducing into evidence a certified copy of the assessment list. A prima facie case is thus established, and the defendant must go forward with his defense. In order to rebut the prima facie case established by the assessments made against the taxpayer, it is necessary to show, by a preponderance of the evidence, that the assessments were incorrect . . . If the assessment has not been the subject of an adjudication, and the Government sues to reduce it to judgment, the taxpayer may contest the correctness of the assessment in that action, and will in effect have to assume the burden of proof on that issue. In such a case, however, if the taxpayer is successful

> in proving by a fair preponderance of the evidence that the assessment is erroneous, the burden shifts to the Government to prove whether any deficiency exists and, if so, in what amount. 9 Mertens, Law of Federal Income Taxation § 49.218 (April 1976) (footnotes omitted).

*Rockwell* v. *Commissioner*, 512 F.2d 882 (9th Cir. 1975), upon which the Government strongly relies, does not require a different result. That case involved disputed income tax deductions, and the court expressly distinguished deduction cases from those, like this one, involving unreported income. *Supra* at 886.

[13] I therefore hold that the taxpayers have the burden of going forward with the evidence and the burden of proving that the Government's assessments, which underlie the prima facie case, are incorrect. If the taxpayers succeed, the burden then shifts to the Government to prove the receipt of unreported income and also the amount of that income. If the Government fails to meet that burden, it cannot prevail.

The taxpayers contend that they proved numerous errors in the Government's assessments. They therefore assert that the presumption of correctness is not available to the Government. The Government denies these contentions, and it argues that even if the taxpayers show that some parts of the assessments are erroneous, the presumption survives for other parts.

[14] In my view, when an assessment has separable parts, the taxpayer has the burden to discredit each

part, and the presumption survives for each part that the taxpayer fails to discredit. If, however, the errors show a pattern of carelessness or arbitrariness by the Commissioner, the presumption disappears for the entire assessment. *Clark* v. *Commissioner*, 266 F.2d 698, 707 (9th Cir. 1959); *Hoffman* v. *Commissioner*, 298 F.2d 784, 788 (3d Cir. 1962); *Foster* v. *Commissioner*, 391 F.2d 727, 735 (4th Cir. 1968); *Anderson* v. *Commissioner*, 250 F.2d 242, 246 (5th Cir. 1957).

[15] This approach is particularly applicable in net worth cases when the Government must determine the taxpayer's unreported income by indirect evidence. As Judge Blackmun (now Mr. Justice Blackmun) said in *Banks* v. *Commissioner*, 322 F.2d 530, 548 (8th Cir. 1963), "Some error in any net worth construction is perhaps to be expected. It is only a 'reasonable certainty' which is required by [*Holland* v. *United States*, 348 U.S. 121, 132, 75 S.Ct. 127, 99 L.Ed. 150 (1954)] and its companion cases." A taxpayer should not be able to discredit all of the Commissioner's determination by showing a few errors when the Commissioner was compelled to use the imprecise net worth method because of the taxpayer's own inadequate, unreliable or fraudulent record-keeping. "[S]kilful concealment [cannot become] an invincible barrier to proof." *United States* v. *Johnson*, 319 U.S. 503, 518, 63 S.Ct 1233, 1240, 87 L.Ed. 1546 (1943); *Banks*, *supra* at 547.

[16] I therefore hold that each part of the Commissioner's determination is entitled to the presumption

of correctness unless the taxpayers prove either that that part of the assessment was wrong or arbitrary or that the entire assessment was arbitrary.

### C. *The Evidence on Tax Liability*

The taxpayers contend that the Commissioner's determination of tax deficiency is not entitled to the presumption of correctness because it is arbitrary and incorrect.[10]

#### 1. *The Community Property Issue*

During the tax years, both taxpayers were married to Philippine citizens. The taxpayers contend that, under Philippine community property law,[11] one-half of most of their income during the tax years belonged

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10. Because the Government relied on the presumption of correctness, it did not introduce evidence to prove each item of unreported income. In its post-trial brief, however, the Government sought to use evidence submitted for a limited purpose to support the correctness of the Commissioner's determination.

The taxpayers moved to strike parts of the Government's brief asserting that the Government incorrectly relied on evidence which had been admitted solely on the issue of fraud.

I will not discuss each objection. I merely repeat what I said at the trial. The Government may rely on any evidence to defend the integrity of the Commissioner's determination against the taxpayers' attacks. The Government may not, however, rely on evidence admitted on the issue of fraud to prove specific items of tax liability.

11. The terms "community property" and "conjugal partnership" are used interchangeably because here they have the same meaning.

to their wives, whose incomes are not subject to United States income taxes. The taxpayers therefore argue that the Commissioner's determination of taxable income is not entitled to the presumption of correctness because it includes their wives' share of the community income.

[17] The Government conceded before trial that the taxpayers "should be taxed on only one-half the income of the conjugal partnership". The Government contends, however, that this error in the Commissioner's determination does not destroy the presumption of correctness for the entire assessment. I agree.

The Commissioner's decision not to apply Philippine community property law to reduce the taxpayers' taxable income involved difficult issues both on the law of conflicts and on the law of Philippine community property. Even the taxpayers' expert on Philippine law testified that the community property issue was "sticky", and the taxpayers acknowledge that experts "differ quite a bit" on the issue. Furthermore, the taxpayers did not make community property claims for their wives in their income tax returns before 1962.

I therefore find that the Commissioner's determination on community property, although incorrect, was reasonable. This error does not prove carelessness or arbitrariness in making the assessment. I therefore hold that the Commissioner's determination, as modified by community property considerations, continues to be entitled to the presumption of correctness.

2. *Opening Net Worth*

The Commissioner used the net worth method to compute the taxpayers' income. The taxpayers contend that the Commissioner's determination of income is overstated because the opening net worth figures of $687,640.90 for Stonehill and $219,782.97 for Brooks are grossly understated.

The taxpayers first contend that the Commissioner "ignored uncontradicted evidence of substantial cash on hand" at the beginning of the tax years when he determined that Stonehill had only $3,904.50 in cash and Brooks had only $31,049.37 in cash. The taxpayers argue that, considering their methods of operation and the size of their business enterprises, those opening cash figures are unrealistic and unreasonable.

The taxpayers rely on *Gunn* v. *Commissioner*, 247 F.2d 359, 362-365 (8th Cir. 1957). There the Commissioner determined that the taxpayer had no cash at the beginning of the tax period. The taxpayer introduced extensive evidence, including testimony by his bookkeeper, his banker, and his accountant, to show that he always had considerable cash on hand for use in his business of buying produce from farmers and selling it to canneries. The bookkeeper testified that the taxpayer regularly kept $2,500 to $5,000 on hand. The court held that, in light of the taxpayer's business history and practice, the Commissioner's determination was unrealistic. The court reversed and remanded for additional hearings.

The taxpayers also rely on *Potson* v. *Commissioner*, 22 T.C. 912, *aff'd sub nom. Bodoglau* v. *Commissioner*, 230 F.2d 336 (7th Cir. 1956), and *Thomas* v. *Commissioner*, 232 F.2d 520 (1st Cir. 1956). In each of these cases, the court held that the Commissioner's determination of opening net worth was wrong because there was substantial evidence showing that the taxpayer had much more cash on hand than the Commissioner's figures showed. In each case, the taxpayer estimated how much cash he had.

Here the Commissioner was faced with many obstacles in his attempt to find all of the taxpayers' opening assets. The taxpayers' business enterprises were complex and widely scattered. Much of the Commissioner's investigation of the taxpayers took place in foreign countries. The taxpayers' records did not accurately reflect their financial operations, and the Commissioner did not have complete access to those records.

[18] Under these circumstances, the Commissioner should not be faulted for his failure to speculate on the amount of additional cash and other assets which the taxpayers may have secreted. In my view, the Commissioner made a reasonable and conscientious effort to find all of the taxpayers' opening assets, and he followed all reasonable leads to obtain such information. When, as here, records are inaccurate and assets concealed, the burden should be and I believe is on the taxpayers to prove the existence and the approximate amount of that cash.

The taxpayers did not meet that burden. Unlike the cases upon which they rely, the taxpayers did not provide any credible evidence on the amount of cash they had at the beginning of the tax period. That evidentiary deficiency was not overcome by a statement from a former employee that in the early 1950's the taxpayers used a great deal of cash in their businesses and that between 1957 and 1962 they illegally sent large amounts of cash to accounts outside of the Philippines. Neither is that deficiency overcome by evidence that in 1957 and 1958 they paid 10 million pesos in cash to high Philippine officials for an exclusive trade permit for the importation of American tobacco. This general evidence shows that at different times the taxpayers did have large sums of cash on hand, but it does not show that on December 31, 1957, the date of the opening net worth, the taxpayers had more cash on hand than was credited to them by the Commissioner. It is just as reasonable to believe that on that date the taxpayers, who had just paid 10 million pesos in cash, were short of cash.

[19] The taxpayers, who might have shed light on their cash position, refused to testify either in person or by deposition. When a party who has special information relevant to his case refuses to testify, the Court may infer that his testimony would be unfavorable to his case. *Stoumen* v. *Commissioner*, 208 F.2d 903, 907 (3d Cir. 1953); McCormick, Evidence § 272 (2d ed. 1972).

[20] I therefore hold that the taxpayers have not met their burden to prove that the Commissioner's determination on the cash they had on hand on December 31, 1957, was either incorrect or arbitrary.

The taxpayers next contend that the Government improperly excluded a major asset from their opening net worth.

In late 1957, the taxpayers made payments totalling 10 million pesos[12] in cash, to high Philippine officials in return for a tobacco barter permit.[13] Until that time, United States tobacco, which was in great demand, could not be imported into the Philippines. The barter permit was the only barter permit for United States tobacco issued by the Philippine government and gave the taxpayers a monopoly on the importation of United States tobacco.

The taxpayers paid for the permit with personal funds, but the permit was formally issued to Philippine Tobacco and Flue-Curing Company (PTFC).[14]

12. At the official currency conversion rate, this was about $5,000,000. At the black market rate, it was about $3,000,000.

13. Some of these payments may have been made in early 1958. Under the Government's theory, the exact date is immaterial.

14. PTFC is a publicly-owned Philippine corporation which grows, processes and stores locally grown tobacco. About one-half of all tobacco grown in the Philippines was processed or stored by PTFC. Stonehill and Peter Lim organized PTFC in 1950; each owned 50 per cent of the stock. PTFC went public about 1953. During the tax years, Stonehill was the president and managing director and owned some stock.

The principal beneficiary of the permit was United States Tobacco Company (USTC)[15] which bought and used most of the imported tobacco to make cigarettes. Universal New York, Inc. (UNY)[16] was designated foreign supplier of the tobacco for importation under the permit.

The taxpayers contend that the 10 million pesos paid for the barter permit should have been "reflected in accounts receivable *from* the corporations or as capital investments *in* the corporations . . ." emphasis in original) The Government contends that the payment was not included in the opening net worth because it was a personal expenditure.

[21] I agree with the taxpayers. The taxpayers "bought" the barter permit because they expected it to generate income and profits from the importation of

15. USTC is a Philippine corporation which manufactures cigarettes. Its principal brands, Old Gold and Kent, are manufactured under a franchise from P. Lorillard Company. Stonehill organized USTC in 1950. Until December 31, 1958, Stonehill owned 65 per cent of the stock. After that date, Stonehill owned 50 per cent and Brooks owned 35 per cent of the stock. During the tax years, Stonehill was chairman of the board, and Brooks was president and general manager. USTC is now known as Quality Tobacco Corporation.

16. UNY is a New York corporation in the import-export business. It was organized in 1947 by Ira Blaustein, a business associate of Stonehill, to be Stonehill's representative in the United States. UNY represented several of Stonehill's enterprises, including PTFC and USTC. After 1950, Stonehill owned 55 per cent of the stock, Blaustein owned 25 per cent, and Brooks owned 10 per cent.

United States tobacco and the sale of cigarettes made from that tobacco. The payment may have been immoral and illegal, but it was a business investment, not a personal expenditure.

Nevertheless, the Commissioner's erroneous exclusion of this asset from the opening net worth does not destroy the presumption of correctness for the entire assessment.

The 10 million peso payment for the permit was an unusual transaction which raised unusual problems for the Commissioner. First, the transaction was illegal. Second, the transaction was not reflected on the books of any of the taxpayers' corporations. Third, the Commissioner's determination that the payment was a personal expenditure was reasonable, although I now conclude that it was not a personal expenditure but a business investment.

I therefore hold that the Commissioner's determination must be modified by adding 10 million pesos to the taxpayers' opening net worth as either an account receivable or a capital investment. The pesos should be converted to dollars at the same rate of exchange that the Government used when it computed the taxpayers' income for the tax years 1958 through 1961.

The taxpayers next contend that the Commissioner understated the value of an asset included in the opening net worth.

At the beginning of the tax period, both taxpayers

owned stock in United States Tobacco Company (USTC). To determine the amount of the taxpayers' investment in that stock, in pesos, the Commissioner relied on reports required to be filed by USTC with the Philippine Securities and Exchange Commission (the PSEC). The Commissioner then converted the pesos to dollars at the black market rate of 3.54 pesos to the dollar.

The taxpayers contend that the Commissioner should have obtained his figures from USTC's accounting reports rather than from the PSEC reports and that the Commissioner should have used the official conversion rate of two pesos to the dollar.

[22] The Commissioner's use of the PSEC figures was proper. The taxpayers cannot now complain about the inaccuracy of figures that they themselves submitted to an official Philippine government agency. Furthermore, the Commissioner's distrust of the company's accounting reports was justified. The taxpayers have frequently acknowledged that the company's records did not fully reflect its operations, and the Government's evidence proves it.

[23] The Commissioner's use of the black market conversion rate was also proper. The taxpayers used that rate on their income tax returns, and they were not prejudiced because the Commissioner used the same conversion rate at both the beginning and the end of the tax period.

3. *Increases in Net Worth*

The Commissioner determined that during the tax years 1958 through 1961 Stonehill's net worth increased about $8,330,000 and Brook's about $7,560,000. The taxpayers contend that the Government did not prove "a likely source" for those net worth increases as required by *Holland* v. *United States*, 348 U.S. 121, 75 S.Ct. 127, 99 L.Ed. 150 (1954).[17]

The taxpayers assume that *Holland* is applicable here even though it was a criminal case. The Government does not discuss whether *Holland* is applicable to a civil tax case or whether the presumption of correctness makes it unnecessary to show a likely source for net worth increases from current taxable income. It is unnecessary for me to decide that issue because I believe the evidence here establishes likely sources.

[24, 25] The taxpayers received large kickbacks through UNY, and they received unreported dividends and interest from investments made even during the tax years. There was also evidence that the taxpayers

17. In *Holland*, the Supreme Court said:

". . . [R]equisite to the use of the net worth method is evidence supporting the inference that the defendant's net worth increases are attributable to currently taxable income.

• • • • •

. . . Increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth increases sprang, is sufficient. . . ." *Supra* at 137-138, 75 S.Ct. at 136.

siphoned large sums of money from USTC,[18] PTFC and numerous other business enterprises which they controlled and that they got kickbacks from Philippine cigarette manufacturers who bought imported tobacco through PTFC. These are "likely sources"; ". . . the Government is not required to negate every possible source of nontaxable income, a matter peculiarly within the knowledge of the [taxpayer]." *Holland, supra,* at 138, 75 S.Ct. at 137.

[26] The taxpayers next contend that the Commissioner improperly increased their closing net worth by erroneously and arbitrarily increasing the amount of their investment in USTC.

Before and during the tax years, the Philippine government had strict currency restrictions. Pesos could be sent out of the country only with the approval of the Central Bank.

During the tax years, the taxpayers regularly sent large sums of pesos out of the Philippines through black market money exchangers. Much of this money was deposited in Swiss bank accounts to the credit of the taxpayers and later used for Philippine companies owned or controlled by the taxpayers.

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18. There was evidence that USTC evaded Philippine cigarette revenue taxes by illegally purchasing some revenue stamps from the printer who supplied the Philippine government with these stamps and that, through unreported sales of cigarettes with these illegal stamps, USTC generated large sums of unreported cash.

In 1958, the taxpayers obtained the tobacco barter permit. The permit was issued to PTFC; it allowed PTFC to import 10,000,000 pounds of United States tobacco on the condition that PTFC export 14,000,000 pounds of Philippine tobacco.[19] The principal beneficary of the permit was USTC; it bought most of the imported tobacco to make cigarettes. In the first 15 months after USTC began to receive United States tobacco for use in its cigarettes, its share of the Philippine cigarette market jumped more than 1500 per cent — from 3.7 per cent to 58 per cent. UNY was the export agent for the United States tobacco which was imported into the Philippines.

Under the permit's currency restrictions, PTFC could spend, through the Central Bank, only $4,900,000 for the United States tobacco, or an average of 49 cents a pound. United States tobacco cost more than 49 cents a pound; it averaged about 75 cents a pound. The taxpayers had to find ways, outside official currency channels, to get the extra funds to UNY in the United States. They sent most of the money through their Swiss bank accounts. UNY obtained additional money in the United States through profits and various special arrangements. For example, UNY required United States tobacco companies to pay it a 3 per cent com-

19. The theory of the barter permit was that the currency derived from the exported Philippine tobacco would be about the same as that expended on the imported United States tobacco. That was not the case. United States tobacco cost about three or four times as much as Philippine tobacco.

mission on all tobacco exported to the Philippines; UNY also received a $12 per ton freight differential on tobacco shipped to the Philippines.

When UNY received an invoice from a United States tobacco company for tobacco shipped to the Phiippines, UNY billed the Philippine purchaser, usually USTC, about 49 cents a pound, although the actual purchase price averaged about 75 cents a pound. To make up the difference, the taxpayer sent money to UNY from their Swiss bank accounts. On its books, UNY credited the money from the Swiss accounts to USTC. There were no complementary entries on USTC's books.

The taxpayers used the same unofficial channels to buy machinery and supplies, such as cigarette paper and filters, for USTC and to pay royalties to P. Lorillard Company on USTC's behalf. During the tax years, the credits to USTC's account at UNY from money going through unofficial channels totalled about $5 million.

The taxpayers also used money from their unofficial channels to buy real estate and securities in the United States. Some of that is the property upon which the Government asserts the liens that it seeks to foreclose in these proceedings.

When the Commissioner computed the value of the taxpayers' closing assets here, he treated the payments through unofficial channels for USTC's account as

capital contributions by the taxpayers to USTC. The value of the taxpayers' investment in USTC and their closing net worth were thereby increased by about $5 million.

The taxpayers contend here that this increase in their net worth was improper. They first contend that the money sent from the Philippines to UNY was corporate rather than personal money. In the alternative, they contend that, if the money did belong to them, it was money they had on hand before the beginning of the tax period rather than from current taxable income.

In the assessment, the Commissioner determined that the money belonged to the taxpayers personally and that it was from current taxable income. His determinations are presumed to be correct, and the taxpayers have the burden to prove that the determinations are wrong. The taxpayers have failed to meet their burden.

[27] The principal test of income tax liability is control or command over the property received. As the court stated in *Corliss* v. *Bowers*, 281 U.S. 376, 378, 50 S.Ct. 336, 337, 74 L.Ed. 916 (1930). "The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not." *See also Burnet* v. *Wells*, 289 U.S. 670, 678, 53 S.Ct. 761, 77 L.Ed. 1439 (1933); *Helvering* v. *Horst*, 311 U.S. 112, 118-119, 61 S.Ct. 144, 85 L.Ed. 75 (1940).

[28] When a controlling stockholder-officer diverts corporate money to his personal control, that money is taxable as a constructive dividend. *Dawkins* v. *Commissioner*, 238 F.2d 174, 178 (8th Cir. 1956); *Hartman* v. *United States*, 245 F.2d 349, 352-353 (8th Cir. 1957).

Here, funds in the Swiss bank accounts belonged to the taxpayers personally and not to their corporations. Although the taxpayers chose to invest some of those funds in USTC by paying some of USTC's bills, the taxpayers could and did spend much of it for their own use; they invested more than $4 million in real estate and securities in the United States.

The taxpayers considered the Swiss bank accounts as their personal accounts. Stonehill and Brooks had separate accounts which were under their individual control. In correspondence, they referred to these accounts as "my account." Stonehill, his wife, and his father executed signature cards which were placed in a sealed envelope and left with bank officials in New York so that in an emergency his wife or father could dispose of securities which Stonehill had purchased with funds from the Swiss accounts.

I find that the money in the Swiss bank accounts belonged to the taxpayers personally.

The taxpayers contend that any money in the Swiss accounts found to belong to them was money that they had before the beginning of the tax years. They failed to prove it.

The taxpayers next contend that part of the money in the Swiss bank accounts came from the repayment by USTC of the 10 million pesos used to obtain the barter permit. Assuming that to be true, the taxpayers, after being credited with $3 million[20] for that repayment, failed to account for an additional $6 million which went into these accounts.

I hold that the Commissioner properly increased the taxpayers' investment in USTC by approximately $5 million, the amount the taxpayers expended for USTC in the United States through unofficial channels.

I also hold that the Commissioner's determinations of tax deficiencies, as modified by this opinion, are correct and not arbitrary. The Government is therefore entitled to judgments against the taxpayers for tax deficiencies.

## V. *Fraud*

The Commissioner assessed fraud penalties of 50 per cent of the taxpayers' tax deficiencies.

[29] "If any part of any underpayment . . . of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. . . ." 26 U.S.C. § 6653(b). "The burden is on the Commissioner to establish by clear and convincing evidence that at least some part of the

20. The black market equivalent for 10 million pesos.

deficiency was due to fraud." *Clark* v. *Commissioner*, 266 F.2d 698, 717 (9th Cir. 1959).

The taxpayers assert that, even if they failed to report and pay taxes on substantial amounts of income, the Government did not prove that this failure was the result of their wilful atempt to evade taxes. I disagree.

During the tax years, both Stonehill and Brooks opened and maintained a number of Swiss bank accounts, several in the names of Liechtenstein establishments or limited companies organized to conceal the fact that they were the real depositors. Whenever one of these Liechtenstein entities became known as a vehicle for the taxpayers, they dissolved that entity and transferred the assets to a new one which they organized.

The taxpayers sent money to these Swiss accounts from the Philippines through black market currency channels. They also sent money from UNY, which was realized from freight differentials and commissions. During the tax years, they sent more than $9 million to Swiss accounts. They later used some of this money to pay bills for USTC. They also used the money to buy real estate and securities for themselves in the names of United States corporations which they organized and which they used to conceal the source of some of the funds.

[30] The taxpayers engaged in elaborate, devious

and complicated transactions through business entities often organized by persons whom the taxpayers arranged to front for them. They also engaged in the other activities described in earlier portions of this opinion. The taxpayers admit that they engaged in many of these activities to evade Philippine currency restrictions and perhaps even Philippine taxes, but they deny that they attempted to evade United States income taxes. I do not believe that their actions can be so limited. I hold that the Government established by clear and convincing evidence that the taxpayers willfully attempted to evade income taxes due the United States government.

The following excerpt from *Spies* v. *United States*, 317 U.S. 492, 499, 63 S.Ct. 364, 368, 87 L.Ed. 418 (1943), is particularly appropriate here:

> Congress did not define or limit the methods by which a willful attempt to defeat and evade might be accomplished and perhaps did not define lest its effort to do so result in some unexpected limitation. Nor would we by definition constrict the scope of the Congressional provision that it may be accomplished "in any manner". By way of illustration, and not by way of limitation, we would think affirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely

effect of which would be to mislead or to conceal. If the tax-evasion motive plays any part in such conduct the offense may be made out even though the conduct may also serve other purposes such as concealment of other crime.

The Commissioner properly assessed and added to the amount of taxpayers' deficiencies fraud penalties of 50 per cent of these tax deficiencies.

## VI. *Conjugal Property*

During the tax years, the wife of each of the taxpayers was a Philippine citizen. The taxpayers' wives, who were joined as defendants in this action, assert interests in the property which the Government seeks to foreclose here.

The wives contend that this property, which their husbands acquired during their marriage, is conjugal property[21] and that the husbands' tax liabilities cannot be satisfied out of the wives' share of the conjugal property.[22] Specifically, they assert that, as Philippine

21. The parties here acknowledge that Philippine community property law is based on "conjugal partnership of gains" and that community property is called "conjugal property".

22. The wives contend that some of the property is their "exclusive property", Civil Code Ann., Art. 148, because it is registered in their names. I disagree. Any property acquired during marriage with conjugal funds remains conjugal property no matter which spouse is recorded as the owner. *Romero de Pratts v. Menzi & Co. and Sheriff of Rizal*, 53 Phil. 51 (1929). The wives do not contend that any of the conjugal property was bought with funds that they had before they married the taxpayers or which they acquired by inheritance or gift.

citizens, they do not owe any United States income taxes and that the taxes which their husbands owe are personal rather than conjugal debts. I disagree.

Article 161 of the Philippine Civil Code Annotated (Padilla 6th ed., 1971) provides: "The conjugal partnership shall be liable for: (1) all debts and obligations contracted by the husband for the benefit of the conjugal partnership. . . ."

[31] Under both this statute and Philippine case law, the debts incurred by a spouse while trying to increase the conjugal property are charged to the conjugal partnership, *Javier* v. *Osmena*, 34 Phil. 336 (1916), even if the other spouse opposes the enterprise. *Abella de Diaz* v. *Erlanger & Galinger, Inc.*, 59 Phil. 326 (1933). As Scaevola, an eminent Spanish commentator, said: ". . . the legal rule that he who shares in the profits, must share in the losses, governs in all its extent; hence the supposition that the husband should pay [expenses incurred to produce income] out of his separate property and in return share the gains obtained with his wife, would be entirely absurd and contrary to all long established principles concerning a partnership." 22 Scaevola, Codigo Civil, p. 246 (1905); *de la Torre* v. *National City Bank of New York*, 110 F.2d 976, 979 n. 2 (1st Cir. 1940).

[32] The community property law of the State of Washington is substantially the same as that of the Philippines. *Helvering* v. *Campbell*, 139 F.2d 865, 870 (4th Cir. 1944). The Washington Supreme Court in

*Hearron* v. *Severyns & Co.*, 159 Wash. 486, 488, 293 P. 458 (1930), said: "We have here, then, the familiar case of an act done by the husband in the interest of the community and from which it derived a direct benefit. In all such cases we have invariably held the community liable, and the cases on the subject are so numerous and the rule so familiar that we refrain from citing authority."

[33] Here, the taxpayers' business enterprises during the tax years increased the conjugal property, and the wives shared in that increase. The taxpayers' United States income taxes are obligations incurred in connection with the acquisition of the additional conjugal property, and their tax liabilites may be satisfied from the wives' share of that property.

This opinion shall constitute findings of fact and conclusions of law pursuant to Fed. R. Civ. P. 52(a).

Counsel for both the Government and the taxpayers shall compute the taxes and penalties due the United States; they shall also submit a judgment in accordance with this opinion.

## APPENDIX D

### EXCERPTS RELATED TO PRESUMPTION

Listed below are verbatim excerpts by counsel and the Court. They indicate that the Government relied on the presumption of correctness.

1. *April 8, 1974 (Pre-trial)*

"JUDGE SOLOMON: . . . How many different issues are there in this case? First you have to establish how much the defendant owes you. Isn't that right?

"MR. BIGGINS: The tax liability, yes.

"JUDGE SOLOMON: And how are you going to do it?

"* * * * *.

"MR. McCARTHY: *Introduction of the assessment list as presumptively correct on the underlying liability.* It doesn't prove fraud. But at that point we have established a liability of over approximately $8 million for Mr. Stonehill and approximately $6 million for Mr. Brooks." (RT 34, 35) [Emphasis supplied.]

2. *April 10, 1975 (Pre-trial)*

"JUDGE SOLOMON: You have the documents and as I understand it, you are *going to rely on the production* [sic presumption].

"MR. BIGGINS: *Yes.*

"JUDGE SOLOMON: All right. You are going to say that they have no right to rely on presumption.

"MR. RAND: That is right. We will file briefs on all of these points." (RT 362-363) [Emphasis supplied.]

3. *May 27, 1975 (Trial)*

"MR. NATHAN: Your Honor, all this is perfectly fine. I think we are not talking about anything that has not happened before. The Government had the choice, and I think they have made the choice, whether to proceed on this original net worth computation and fall short of it; but if they do, I argue to Your Honor, they are not aided by the presumption; and they have to prove that we owe some taxes. How they are doing it is up to them.

"THE COURT: I told them that already. But insofar as any stipulation or concession you made, I am going to construe that as applying only to the community property here.

"MR. BIGGINS: Thank you, Your Honor. On the case in chief, *we will go on the presumption* because of the enormous quantity of boxes on there, to proceed now on the net worth method, would be a trial of two or three months . . ." (RT 20-21) [Emphasis supplied.]

"* * * * *

*"THE COURT: Wait a minute. I thought you were going to rely on the presumption?*

*"MR. BIGGINS: I am, Your Honor.*

"THE COURT: Why are you offering these documents [portion of 36 volumes]?

"MR. BIGGINS. I have to prove fraud . . . These

documents will provide specific items of fraud." (RT 38-39) [Emphasis supplied.]

"* * * * *.

"THE COURT: I would like to ask you if Volumes Six, Seven and Eight are being offered for the purpose of proving fraud?

"MR. BIGGINS: Yes and specific items of omitted income, yes.

"THE COURT: Why would you do that if you are going on the presumption of validity? Are you abandoning that? Are you going to prove that he omitted certain items of income and seeking to get a judgment against him based upon the failure to record specific items?

"MR. BIGGINS: *No, I stand by the presumption.* . . ." (RT 43) [Emphasis supplied.]

"* * * * *.

"MR. BIGGINS: Volume Fifteen, correspondence with Michael Meyer, copied by IRS in Manila.

"Volume Sixteen, correspondence with Michael Meyer, copied by IRS in Manila.

"Volume Seventeen, correspondence with Albert Penet, copied by the IRS in Manila.

"MR. NATHAN: Same objection.

"THE COURT: As I understand it, Mr. Biggins, this is only being offered on the issue of fraud?

"MR. BIGGINS: Yes, Your Honor. *We are going on the presumption as to the tax.* This is to establish badges of fraud." (RT 48-49) [Emphasis supplied.]

4. *May 28, 1975 (Trial)*

"MR. BIGGINS: [Regarding Vol. 6] Only on the issue of fraud, yes, sir. It's a specific item of fraud, as evidence of fraud. *But I am not changing the method of computing deficiencies by going to specific methods, no, sir.*" (RT 141) [Emphasis supplied.]

"* * * * *.

"THE COURT: . . . you [Biggins] were given the privilege of proving the correct amount of the deficiency. *You elected to put in the deficiency and rely on the presumption* and require the defendants to go forward with the evidence. I permitted you to put in some evidence through Mr. Ragland solely for the purpose of showing fraud in order to comply with your obligation to show that there was not only a deficiency, but there was a fraudulent withholding of information or payment. . . ." (RT 170-171) [Emphasis supplied.]

"* * * * *.

"THE COURT: Maybe I'd better talk about the evidence in this case. The Government decided a long time ago that it was going to make a deficiency assessment. They filed a deficiency certificate showing that Mr. Stonehill owed twelve million dollars in taxes, and Mr. Brooks some eight or nine million dollars. After some years, the Government, instead of proving specific items of omissions, elected to go on the theory of regularity and accuracy of this deficiency assessment. Therefore, it put the burden on the defendants to go forward with the evidence." (RT 276-277).

"THE COURT: . . . After some years, the *Government, instead of proving specific items of omissions, elected to go on the theory of regularity and accuracy of this deficiency assessment.* . . .

"* * * * *

"[THE COURT]: The Government came in and relied on the presumption for the purpose of showing fraud, as I think the Government must show. I permitted them to introduce the testimony of Mr. Ragland and also show evidence solely for the purpose of showing fraud." (RT 277-278) [Emphasis supplied.]

5. *May 29, 30, 1975 (Trial)*

"THE COURT: . . . The Government introduced its certificate of deficiency in which they found Stonehill owed some twelve million dollars and Brooks owed a little less than that. *The Government has proceeded on the theory of the presumption of regularity and accuracy.*" (RT 397) [Emphasis supplied.]

"* * * * *

"THE COURT: . . . Something was said here a few minutes ago by Mr. Biggins which, perhaps, I don't really understand. He said in view of the revelation here, he would have to make the record more complete. I don't know what he means by that. *I don't think he can now shift to proof on specific items of omission. He has committed himself to the issue of regularity and accuracy.* . . .

"MR. BIGGINS: Does the Court wish me to respond?

"THE COURT: That's right.

"MR. BIGGINS: *I do not intend to shift ground.*" (RT 402) [Emphasis supplied.]

6. *September 22, 1975 (Post-Trial)*

"THE COURT: Is that what you are wanting to do? Are you trying now to show specific items rather than to rely on the presumption?

"MR. BIGGINS: Well, I have indicated from the beginning, and did show at trial in the volumes, many specific items. I do believe the Court's question rather was do I intend to go on affirmative proof of the net worth rather than the presumption.

"THE COURT: Yes.

"MR. BIGGINS: My answer to that is no, Your Honor, we did go to the evidence on presumption and here we are." (RT 17).

"* * * * *.

"THE COURT: *Mr. Biggins is going to rely on the presumption.* And then he is also going to show fraud. I think he has to show fraud.

"MR. BIGGINS: Yes." (RT 29) [Emphasis supplied.]

7. *March 29, 1976 (Post Trial).*

"MR. RAND: If you want to, go ahead and do it. It seems to me you are going to have to stand on your presumption or you are going to have to put in all your evidence.

"MR. BIGGINS: What did he say before that?

"MR. RAND: That is the Court's function, to give your option.

"MR. BIGGINS: What phrase did you leave out, before that?

"MR. RAND: What phrase did I leave out?

"MR. BIGGINS: Yes.

"MR. RAND: You don't have to —

"MR. BIGGINS: There we are, there we are.

"MR. RAND: 'But if you want to, go ahead and do it.'

"THE COURT: Well, I think, Mr. Biggins, that merely shows that you had two options at that time. You could stand on the presumption or you could put in all your evidence.

"MR. BIGGINS: I understood both those options, Your Honor, yes. *I was confronted with a three or four-month trial or could go on the presumption and I made my decision and I am stuck with it.*" (RT 92).

8. *Solomon's Opinion (July 23, 1976)*

"I therefore hold that each part of the Commissioner's determination is *entitled to the presumption of correctness* unless the taxpayers prove either that that part of the assessment was wrong or arbitrary or that the entire assessment was arbitrary." (420 F.Supp 46, p. 57) [Emphasis supplied.]

"*Because the Government relied on the presumption of correctness*, it did not introduce evidence to prove each item of unreported income." (420 F. Supp 46, p. 57) [Emphasis supplied.]

"The Government contends, however, that this error [community property] in the Commissioner's determination does not destroy *the presumption of correctness for the entire assessment.*" (420 F.Supp 46, p. 57) [Emphasis supplied.].

"In the assessment, the Commissioner determined that the money belonged to the taxpayers personally and that it was from current taxable income. *His determinations are presumed to be correct. . . .*" (420 F.Supp 46, 61) [Emphasis supplied.]

9. *December 20, 1976 (Post-Trial)*

*"THE COURT: And the Government elected to proceed on the basis of the presumption of validity. They were stuck with that theory.* They decided they wouldn't go into the evidence." (RT 21) [Emphasis supplied.]

10. *May 5,1978 (Post-Trial)*

"THE COURT: Let me tell you something. It may be impossible and if that's the case, then maybe we can't levy any taxes. But I thought that what *I decided is that the levy and the assessment imports that there is a presumption of correctness.*" (RT 33) [Emphasis supplied.]

"* * * * *.

"MR. RAND: Well, what happened at the trial. You see, Judge — maybe I'm wrong. I wish the Court would tell me. *We went into trial and Mr. Biggins put in his bare assessment, and then he rested.*

"THE COURT: *Yes.*

"MR. RAND: *He rested.*

"THE COURT: *Yes.*" (RT 45).

## APPENDIX E

## CONSTITUTIONAL AND STATUTORY PROVISIONS

(All Statutory Provisions Appear in Current Status)

### AMENDMENT V

### UNITED STATES CONSTITUTION

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

### STATUTORY PROVISIONS

**26 U.S.C. § 63. Taxable Income Defined.**

*(a) Corporations.*—For purposes of this subtitle, in the case of a corporation, the term "taxable income" means gross income minus the deductions allowed by this chapter.

*(b) Individuals.*—For purposes of this subtitle, in the case of an individual, the term "taxable income" means adjusted gross income —

(1) reduced by the sum of —

(A) the excess itemized deductions,

(B) the deductions for personal exemptions provided by section 151, and

(C) the direct charitable deduction, and

(2) increased (in the case of an individual for whom an unused zero bracket amount computation is provided by subsection (e)) by the unused zero bracket amount (if any).

. . . . .

**26 U.S.C. § 6212. Notice of deficiency.**

*(a) In general.*—If the Secretary determines that there is a deficiency in respect of any tax imposed by subtitles A or B or chapter 41, 42, 43, 44, or 45, he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.

*(b) Address for notice of deficiency.*—

*(1) Income and gift taxes and certain excise taxes.*—In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, chapter 44, or chapter 45, if mailed to the taxpayer at his last known address, shall be sufficient for purposes of subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, chapter 44, chapter 45, and this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

*(2) Joint income tax return.*— In the case of a joint income tax return filed by husband and wife, such notice of deficiency may be a single joint notice, except that if the Secretary has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, a duplicate original of the joint notice shall be sent by certified mail or registered mail to each spouse at his last known address.

*(3) Estate tax.*—In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by chapter 11, if addressed in the name of the decedent or other person subject to liability and mailed to his last known address, shall be sufficient for purposes of chapter 11 and of this chapter.

*(c) Further deficiency letters restricted.*—

*(1) General rule.*— If the Secretary has mailed to the taxpayer a notice of deficiency as provided in subsection (a), and the taxpayer files a petition with the Tax Court within the time prescribed in section 6213(a), the Secretary shall have no right to determine any additional deficiency of income tax for the same taxable year, of gift tax for the same calendar year, of estate tax in respect of the taxable estate of the same decedent, of chapter 41 tax for the same taxable year, of chapter 43 tax for the same taxable year, of chapter 44 tax for the same taxable year, of section 4940 tax for the same taxable year, of chapter 42 tax (other than under section 4940) with

respect to any act (or failure to act) to which such petition relates, or of chapter 45 tax for the same taxable period, except in the case of fraud, and except as provided in section 6214(a) (relating to assertion of greater deficiencies before the Tax Court), in section 6213(b)(1) (relating to mathematical or clerical errors), in section 6851 (relating to termination assessments), or in section 6861(c) (relating to the making of jeopardy assessments).

*(2) Cross references.—*

*For assessment as a deficiency notwithstanding the prohibition of further deficiency letters, in the case of—*

*(A) Deficiency attributable to change of treatment with respect to itemized deductions and zero bracket amount, see section 63(g)(5).*

*(B) Deficiency attributable to gain on involuntary conversion, see section 1033(a)(2)(C) and (D).*

*(C) Deficiency attributable to gain on sale or exchange of principal residence, see section 1034(j).*

*(D) Repealed. Pub.L. 94-455, Title XIX, § 1901(b)(37)(C), Oct. 4, 1976, 90 Stat. 1803.*

*(E) Deficiency attributable to activities not engaged in for profit, see section 183(e)(4).*

**26 U.S.C. § 6861. Jeopardy assessments of income, estate, and gift taxes.**

*(a) Authority for making.*—If the Secretary or

his delegate believes that the assessment or collection of a deficiency, as defined in section 6211, will be jeopardized by delay, he shall, notwithstanding the provisions of section 6213(a), immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and demand shall be made by the Secretary or his delegate for the payment thereof.

*(b) Deficiency letters.*—If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 6212(a), then the Secretary or his delegate shall mail a notice under such subsection within 60 days after the making of the assessment.

*(c) Amount assessable before decision of Tax Court.*—The jeopardy assessment may be made in respect of a deficiency greater or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 6212(c) prohibiting the determination of additional deficiencies, and whether or not the taxpayer has theretofore filed a petition with the Tax Court. The Secretary or his delegate may, at any time before the decision of the Tax Court is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. The Secretary or his delegate shall notify the Tax Court of the amount of such assessment, or abatement, if the petition is filed with the Tax Court before the making of the assessment or is subsequently filed, and the Tax Court shall have jurisdiction to re-

determine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith.

*(d) Amount assessable after decision of Tax Court.*—If the jeopardy assessment is made after the decision of the Tax Court is rendered, such assessment may be made only in respect of the deficiency determined by the Tax Court in its decision.

*(e) Expiration of right to assess.*—A jeopardy assessment may not be made after the decision of the Tax Court has become final or after the taxpayer has filed a petition for review of the decision of the Tax Court.

*(f) Collection of unpaid amounts.*—When the petition has been filed with the Tax Court and when the amount which should have been assessed has been determined by a decision of the Tax Court which has become final, then any unpaid portion, the collection of which has been stayed by bond as provided in section 6863(b) shall be collected as part of the tax upon notice and demand from the Secretary or his delegate, and any remaining portion of the assessment shall be abated. If the amount already collected exceeds the amount determined as the amount which should have been assessed, such excess shall be credited or refunded to the taxpayer as provided in section 6402, without the filing of claim therefor. If the amount determined as the amount which should have been assessed is greater than the amount actually assessed, then the difference

shall be assessed and shall be collected as part of the tax upon notice and demand from the Secretary or his delegate.

*(g) Abatement if jeopardy does not exist.*—The Secretary or his delegate may abate the jeopardy assessment if he finds that jeopardy does not exist. Such abatement may not be made after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with the Tax Court, after the expiration of the period for filing such petition. The period of limitation on the making of assessments and levy or a proceeding in court for collection, in respect of any deficiency, shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the 10th day after the day on which such jeopardy assessment is abated.

*(h) Cross references.—*

*(1) For the effect of the furnishing of security for payment, see section 6863.*

*(2) For provision permitting immediate levy in case of jeopardy, see section 6331(a).*

**26 U.S.C. § 7401. Authorization.**

No civil action for the collection or recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Secretary or his delegate authorizes or sanctions the proceedings and the Attorney General or his delegate directs that the action be commenced.

**26 U.S.C. § 7402. Jurisdiction of district courts.**

*(a) To issue orders, processes, and judgments.*—The district courts of the United States at the instance of the United States shall have such jurisdiction to make and issue in civil actions, writs and orders of injunction, and of *ne exeat republica*, orders appointing receivers, and such other orders and processes, and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such laws.

*(b) To enforce summons.*—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides or may be found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

*(c) For damages to United States officers or employees.*—Any officer or employee of the United States acting under authority of this title, or any person acting under or by authority of any such officer or employee, receiving any injury to his person or property in the discharge of his duty shall be entitled to maintain an action for damages therefor, in the district court of the United States, in the district wherein the party doing the injury may reside or shall be found.

*(e) To quiet title.*—The United States district courts shall have jurisdiction of any action brought by the United States to quiet title to property if the title claimed by the United States to such property was derived from enforcement of a lien under this title.

*(f) General jurisdiction.*—

*For general jurisdiction of the district courts of the United States in civil actions involving internal revenue, see section 1340 of title 28 of the United States Code.*

**26 U.S.C. § 7403. Action to enforce lien or to subject property to payment of tax.**

*(a) Filing.*—In any case where there has been a refusal or neglect to pay any tax, or to discharge any liability in respect thereof, whether or not levy has been made, the Attorney General or his delegate, at the request of the Secretary, may direct a civil action to be filed in a district court of the United States to enforce the lien of the United States under this title with respect to such tax or liability or to subject any property, of whatever nature, of the delinquent, or in which he has any right, title, or interest, to the payment of such tax or liability. For purposes of the preceeding sentence, any acceleration of payment under section 6166(g) shall be treated as a neglect to pay tax.

*(b) Parties.*—All persons having liens upon or claiming any interest in the property involved in such action shall be made parties thereto.

*(c) Adjudication and decree.*—The court shall,

after the parties have been duly notified of the action, proceed to adjudicate all matters involved therein and finally determine the merits of all claims to and liens upon the property, and , in all cases where a claim or interest of the United States therein is established, may decree a sale of such property, by the proper officer of the court, and a distribution of the proceeds of such sale according to the findings of the court in respect to the interests of the parties and of the United States. If the property is sold to satisfy a first lien held by the United States, the United States may bid at the sale such sum, not exceeding the amount of such lien with expenses of sale, as the Secretary or his delegate directs.

*(d) Receivership.*—In any such proceeding, at the instance of the United States, the court may appoint a receiver to enforce the lien, or, upon certification by the Secretary or his delegate during the pendency of such proceedings that it is in the public interest, may appoint a receiver with all the powers of a receiver in equity.

**28 U.S.C. § 1254. Courts of appeals; certiorari; appeal; certified questions.**

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By appeal by a party relying on a State statute held by a court of appeals to be invalid as repugnant

to the Constitution, treaties or laws of the United States, but such appeal shall preclude review by writ of certiorari at the instance of such appellant, and the review on appeal shall be restricted to the Federal questions presented;

(3) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

**28 U.S.C. § 1291. Final decisions of district courts.**

The courts of appeals (other than the United States Court of Appeals for the Federal Circuit) shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court. The jurisdiction of the United States Court of Appeals for the Federal Circuit shall be limited to the jurisdiction described in sections 1292(c) and (d) and 1295 of this title.

**28 U.S.C. § 1340. Internal revenue; customs duties.**

The district courts shall have original jurisdiction of any civil action arising under any Act of Congress providing for internal revenue, or revenue from imports or tonnage except matters within the jurisdiction of the Court of International Trade.

**28 U.S.C. § 1345. United States as plaintiff.**

Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

**28 U.S.C. § 2101. Supreme Court; time for appeal or certiorari; docketing; stay.**

(a) A direct appeal to the Supreme Court from any decision under sections 1252, 1253 and 2282 of this title, holding unconstitutional in whole or in part, any Act of Congress, shall be taken within thirty days after the entry of the interlocutory or final order, judgment or decree. The record shall be made up and the case docketed within sixty days from the time such appeal is taken under rules prescribed by the Supreme Court.

(b) Any other direct appeal to the Supreme Court which is authorized by law, from a decision of a district court in any civil action, suit or proceeding, shall be taken within thirty days from the judgment, order or decree, appealed from, if interlocutory, and within sixty days if final.

(c) Any other appeal or any writ of certiorari intended to bring any judgment or decree in a civil action, suit or proceeding before the Supreme Court for review shall be taken or applied for within ninety days after the entry of such judgment or decree. A justice of the Supreme Court, for good cause shown, may extend the time for applying for a writ of certiorari for a period not exceeding sixty days.

(d) The time for appeal or application for a writ of certiorari to review the judgment of a State court in a criminal case shall be as prescribed by rules of the Supreme Court.

(e) An application to the Supreme Court for a writ of certiorari and review a case before judgment has been rendered in the Court of Appeals may be made at any time before judgment.

(f) In any case in which the final judgment or decree of any court is subject to review by the Supreme Court on writ of certiorari, the execution and enforcement of such judgment or decree may be stayed for a reasonable time to enable the party aggrieved to obtain a writ of certiorari from the Supreme Court. The stay may be granted by a judge of the court rendering the judgment or decree or by a justice of the Supreme Court, and may be conditioned on the giving of security, approved by such judge or justice, that if the aggrieved party fails to make application for such writ within the period allotted therefor, or fails to obtain an order granting his application, or fails to make his plea good in the Supreme Court, he shall answer for all damages and costs which the other party may sustain by reason of the stay.

## CERTIFICATE OF ASSESSMENTS AND PAYMENTS

| NAME OF TAXPAYER | ADDRESS (Number, street, city, and State) | CLASS OF TAX | DATE OF REQUEST |
|---|---|---|---|
| Harry S Stonehill | Box 2071<br>1550 W Georgia<br>Vancouver BC, Canada | Individual Income | 2-15-65 |

| TAXABLE PERIOD (a) | ACCOUNT NUMBER (b) | RECEIVED OR SCHEDULED DATE (c) | DESCRIPTION (d) | LIABILITY AND (ABATEMENT) (e) | PAYMENTS AND CREDITS APPLIED (f) | BALANCE (g) | REFUNDS AND CREDITS ALLOWED (h) | SUPPLEMENTAL INFORMATION (i) |
|---|---|---|---|---|---|---|---|---|
| | | | JEOPARDY ASSESSMENTS* | | | | | |
| 1958 | D 63/65 | 1/18/65 | Tax | 395,100.53 | | | | Assessed 1-18-65 |
| | | | Penalty | 197,550.27 | | | | First Notice 1-18-65 |
| | | | Interest | 136,504.53 | | 729,155.33 | | Delinquent Account Issued 1-18-65 |
| 1959 | D 64/65 | 1/18/65 | Tax | 2,505,364.59 | | | | Assessed 1-18-65 |
| | | | Penalty | 1,252,682.30 | | | | First Notice 1-18-65 |
| | | | Interest | 715,264.43 | | 4,473,311.32 | | Delinquent Account Issued 1-18-65 |
| 1960 | D 65/65 | 1/18/65 | Tax | 2,259,503.83 | | | | Assessed 1-18-65 |
| | | | Penalty | 1,129,751.92 | | | | First Notice 1-18-65 |
| | | | Interest | 509,502.64 | | 3,898,758.39 | | Delinquent Account Issued 1-18-65 |
| 1961 | D 66/65 | 1/18/65 | Tax | 2,709,405.60 | | | | Assessed 1-18-65 |
| | | | Penalty | 1,354,702.80 | | | | First Notice 1-18-65 |
| | | | Interest | 448,388.07 | | 4,512,496.47 | | Delinquent Account Issued 1-18-65 |

* All accounts assessed under Section 6861 IRC 1954

I certify that the foregoing transcript of the account of the taxpayer named above in respect to the items specified is a true and complete transcript for the period stated, and ... assessments, payments, penalties, interest, abatements, credits, and refunds relating thereto as disclosed by the records of this office and others therein.

... OF DISTRICT DIRECTOR

... OF INTERNAL REVENUE

DATE

APP-3
APPENDIX C-1

CERTIFICATE OF ASSESSMENTS AND PAYMENTS

| NAME OF TAXPAYER | ADDRESS (Number, street, city, and State) | CLASS OF TAX | DATE OF REQUEST |
|---|---|---|---|
| Robert P Brooks | 6182 Collingwood Place<br>Vancouver BC Canada | Individual<br>Income | 2-15-65 |

| TAXABLE PERIOD (a) | ACCOUNT NUMBER (b) | RECEIVED OR SCHEDULED DATE (c) | DESCRIPTION (d) | LIABILITY AND (ARREARMENT) (e) | PAYMENTS AND CREDITS APPLIED (f) | BALANCE (g) | REFUNDS AND CREDITS ALLOWED (h) | SUPPLEMENTAL INFORMATION (i) |
|---|---|---|---|---|---|---|---|---|
| | | | JEOPARDY ASSESSMENT* | | | | | |
| 1958 | D 59/65 | 1/18/65 | Tax | 180,899.00 | | | | Assessed 1-18-65 |
| | | | Penalty | 94,449.94 | | | | First Notice 1-18-65 |
| | | | Interest | 65,263.61 | | 340,613.43 | | Delinquent Account Issued 1-18-65 |
| 1959 | D 60/65 | 1/18/65 | Tax | 1,639,912.56 | | | | Assessed 1-18-65 |
| | | | Penalty | 819,956.28 | | | | First Notice 1-18-65 |
| | | | Interest | 468,183.80 | | 2,928,052.64 | | Delinquent Account Issued 1-18-65 |
| 1960 | D 61/65 | 1/18/65 | Tax | 2,007,572.31 | | | | Assessed 1-18-65 |
| | | | Penalty | 1,003,786.16 | | | | First Notice 1-18-65 |
| | | | Interest | 452,693.80 | | 3,464,052.27 | | Delinquent Account Issued 1-18-65 |
| 1961 | D 62/65 | 1/18/65 | Tax | 2,667,227.05 | | | | Assessed 1-18-65 |
| | | | Penalty | 1,333,613.53 | | | | First Notice 1-18-65 |
| | | | Interest | 441,407.81 | | 4,442,248.39 | | Delinquent Account Issued 1-18-65 |

* All accounts assessed under Section 6861 IRC 1954

I certify that the foregoing transcript of the account of the taxpayer named above in respect to the taxes specified is a true and complete transcript for the period stated, and all assessments, payments, penalties, interest, abatements, credits, and refunds relating thereto as disclosed by the records of this office are shown thereon.

SIGNATURE OF DISTRICT DIRECTOR

DIRECTOR OF INTERNATIONAL OPERATIONS
P. O. BOX 19007
WASHINGTON, D. C. 20036

DATE 2-15-65

Dear

FORM 899 (REV. 11-54)

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Appendix C

App-4

**APPENDIX G**

IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT
OF CALIFORNIA

| | |
|---|---|
| UNITED STATES OF AMERICA, *Plaintiff*, | Date Entry: October 14, 1980 |
| v. | |
| HARRY S. STONEHILL, et al., *Defendants.* | Civil No. 65-127 GJS |
| PACITA CARRION BROOKS, *Intervenor.* | JUDGMENT |

IT IS ORDERED that:

1. The plaintiff United States of America recover $8,984,668.48 from Harry S. Stonehill for income taxes, penalties and interest to January 31, 1980 for the years 1958, 1959, 1960 and 1961, with interest accruing on the sum of $4,926,925 after January 31, 1980 at the rate of 12 percent per annum as provided by Section 6621(a) of the Internal Revenue Code up to the date of this Judgment, plus interest thereafter according to law.

2. The plaintiff United States of America recover $8,667,658.29 from Robert P. Brooks for income taxes, penalties and interest to January 31, 1980 for the years 1958, 1959, 1960 and 1961 with interest accruing on the sum of $4,743,789 after January 31, 1980 at the rate of 12 percent per annum as provided by Section 6621(a) of the Internal Revenue Code up

to the date of this Judgment, plus interest thereafter according to law.

3. The action of intervention filed by Pacita Carrion Brooks is dismissed with prejudice.

4. Plaintiff United States of America has a valid and perfected lien against the following property and subject to Paragraph 5 of this Judgment plaintiff's lien is foreclosed against the following property:

The following items (a) through (f) held by National Savings & Trust Company, Washington, D.C. Signatories: Trammell, Rand, Nathan & Lincoln, PC, at Trustees, and Joseph G. McGowan, Director of International Operations, Internal Revenue Service.

(a) *Certificate of Deposit No.* 05-60-09331 in the amount of $271,378.47, Maturity Date: October 22, 1980, Representing proceeds from the sale of Haromu Properties;

(b) *Certificate of Deposit No.* 05-60-09405 in the amount of $46,198.66, Maturity Date: November 25, 1980, Representing monies due to Greentree Investment Corporation (Holexa S. A. claiming as successor in interest) resulting from the sale of 8455 Beverly Boulevard;

(c) *Certificate of Deposit No.* 05-60-09588 in the amount of $50,104.96, Maturity Date: February 13, 1981, Representing monies owned by Joe Steinberg resulting from the sale of 8455 Beverly Boulevard;

(d) *Certificate of Deposit No.* 05-60-09471 in the amount of $107,222.76, Maturity Date: Novem-

ber 28, 1980, Representing proceeds from the sale of Tierra Ranch, Inc.;

(e) *Checking Account No.* 057-1196443 in the current amount of $46.77, used for stipulated disbursements;

(f) *Checking Account No.* 057-1196377 in the current amount of $46.77, used for stipulated disbursements.

The following items (g) and (h) are held by Coast and Southern Federal Savings and Loan Association, Los Angeles, California:

(g) *Account No.* 9-704459-8 in the amount of $5,554.61, Representing proceeds from the sale of Harjo Apartments. Signatories: The Steinbergs and Joseph G. McGowan, Director of International Operations, Internal Revenue Service;

(h) *Account No.* 9-71778-6 in the amount of $76,739.58, Representing proceeds from the sale of the film "To Be A Man." Signatories: Petramonte Productions and Joseph G. McGowan, Director of International Operations, Internal Revenue Service.

(i) *United California Bank* account in the amount of $1,253.11 in the name of Haromu Properties;

(j) *Home Savings and Loan (Beverly Hills, California) Account No.* 04-194204-6 in the amount of $396.28, in the name of Haromu Partnership.

(k) *Home Savings and Loan (Beverly Hills, California) Account No.* 04-179877-8 in the amount of $44,492.99, Maturity Date: December 8, 1980, in the name of Haromu Partnership.

Subject to Paragraph 5 of this Judgment, said

property is to be redeemed or converted to cash and delivered to the Clerk of the Court to be applied in satisfaction of plaintiff's Judgment.

5. Execution, or any foreclosure of lien or other action in aid thereof, under this Judgment is hereby stayed until this decision and Judgment has been affirmed by the highest court having jurisdiction of the parties and the subject matter or, in the event that no appeal has been taken or no petition for certiorari has been filed, as the case may be, after the time for taking such appeal or for filing such petition for certiorari has expired.

6. Pursuant to the Stipulation and Order of this Court dated April 9, 1965, this Judgment shall be entered as the Judgment of the United States District Court for the Northern District of California in Civil Action No. 43244 and of the United States District Court for the District of Hawaii in Civil Action No. 2348 after this decision and judgment has been affirmed by the highest court having jurisdiction of the parties and the subject matter or, in the event that no appeal has been taken or no pettiion for certiorari has been filed, as the case may be, after the timefor taking such appeal or for filing such petition for certiorari has expired.

7. All other parties to this action recover nothing and their claims are dismissed with prejudice.

DATED this 10th day of October, 1980.

*Gus J. Solomon*
United States District Judge

**APPENDIX H**

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT
OF CALIFORNIA

| | |
|---|---|
| UNITED STATES OF AMERICA, *Plaintiff*, | Date Entry: October 14, 1980 |
| v. | Civil No. 43244 |
| HHARRY S. STONEHILL, et al., *Defendants.* | JUDGMENT |
| TRAMMEL, RAND, NATHAN & LINCOLN, a Partnership, *Intervenor.* | |

IT IS ORDERED that:

1. Pursuant to the Stipulation and Order of this Court dated May 6, 1965, the decision and judgment of the Court of the United States District Court for the Central District of California in Civil Action No. 65-127-GJS dated October 10, 1980, will be entered as the judgment of this Court after said decision and judgment has been affirmed by the highest court having jurisdiction of the parties and the subject matter or, in the event that no appeal has been taken or no petition for certiorari has been filed, as the case may be, after the time for taking such appeal or for filing such petition for ctertirari has expired.

2. Plaintiff has a valid and perfected lien against the following property and, subject to Paragraph 3 of this Judgment, plaintiff's lien is foreclosed against the following property:

(a) *Certificate of Deposit No.* 05-60-09553 in the amount of $104,265.73, Maturity Date: November 3, 1980, Representing monies transferred by the Lourdes Blanco Stonehill Children's Trust in settlement of all claims against the trust and Brookwood-Orinda Associates. Held by: National Savings and Trust Company, Washington, D. C. Signatories: Trammell, Rand, Nathan & Lincoln, PC, as Trustees, and Joseph G. McGowan, Director of International Operations, Internal Revenue Service;

(b) *Pine Street Management Corporation Stock*, 250 shares, San Francisco, California in the following names:

| | |
|---|---|
| Harry F. Stonehill | 75 Shares |
| Lourdes B. Stonehill | 50 Shares |
| Robert P. Brooks | 75 Shares |
| Pacita C. Brooks | 50 Shares |

Subject to Paragraph 3 of this Judgment, said property is to be redeemed or converted to cash and delivered to the Clerk of the Court or sold by the United States Marshall in the manner provided by law, to be applied in satisfaction of plaintiff's Judgment after payment of the costs and disbursement of sale.

3. Execution or any foreclosure of liens or other action in aid thereof under this Judgment is hereby stayed until said decision and Judgment of the United States District Court for the Central District of California in Civil Action 65-127-GJS dated October 10, 1980 has been affirmed by the highest court having jurisdiction of the parties and the subject matter or,

in the event that no appeal has been taken or no petion for certiorari has been filed, as the case may be, after the time for taking such appeal or for filing such petition for certiorari has expired. Thereafter, plaintiff may foreclose against any assets belonging to defendants Harry S. Stonehill and Robert P. Brooks within the jurisdiction of this Court to the extent that assets under the jurisdiction of the Central District of California shall be insufficient to satisfy such judgment.

4. The action in intervention filed by Trammell, Rand, Nathan & Lincoln, a Partnership, is dismissed with prejudice.

5. Plaintiff's claims against Harry S. Stonehill as trustee of the Lourdes Blanco Stonehill Children's Trust, and the Elizabeth Ann Stonehill Trust, and the Susan Jane Stonehill Trust and the Harry Steven Stonehill, Jr. Trust and the Michael Joseph Stonehill Trust, Elizabeth Ann Stonehill, Susan Jane Stonehill, Harry Steven Stonehill, Jr., Michael Joseph Stonehill and Peter O. Mattei are hereby dismissed with prejudice.

6. All other parties to this action recover nothing and their claims are dismissed with prejudice.

DATED this 10th day of October, 1980.

*Gus J. Solomon*
United States District Judge

**APPENDIX I**

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, *Plaintiff*, ) Date Entry: October 14, 1980
v. )
) Civil No. 2348
HARRY S. STONEHILL, et al., *Defendants.* ) JUDGMENT

IT IS ORDERED that:

1. Pursuant to the Stipulation and Order of this Court dated August 14, 1970, the decision and judgment of the United States District Court for the Central District of California in Civil Action No. 65-127-GJS dated October 10, 1980 will be entered as the Judgment of this Court after said decision and judgment has been affirmed by the highest court having jurisdiction of the parties and the subject matter or, in the event that no appeal has been taken or no petition for certiorari has been filed, as the case may be, after the time for taking such appeal or for filing such petition for certiorari has expired.

2. Plaintiff has a valid and perfected lien against the following property and subject to Paragraph 3 of this Judgment plaintiff's lien is foreclosed against the following property:

(a) *Tower Development Corporation Stock*, 4,900 Shares, Honolulu, Hawaii, in the following names:

Harry S. Stonehill 950 Shares
Robert P. Brooks 3,950 Shares

(b) Liabilities reflected in the financial statement of Tower Development Corporation as of January 31, 1979, totalling: $491,643, plus accrued interest of $473,207. Representing loans payable to Baer Bank, Holexa, S.A., claiming such obligations as successor in interest.

Subject to Paragraph 3 of this Judgment, said property is to be redeemed or converted to cash and delivered to the Clerk of the Court or sold by the United States Marshall in the manner provided by law, to be applied in satisfaction of plaintiff's judgment after payment of the costs and disbursements of sale.

3. Execution or any foreclosure of lien or other action in aid thereof under this Judgment is hereby stayed until said decision and Judgment of the United States District Court for the Central District of California in Civil Action No. 65-127-GJS dated October 10, 1980 has been affirmed by the highest court having jurisdiction of the parties and the subject matter or, in the event that no appeal has been taken or no petition for certiorari has been filed, as the case may be, after the time for taking such appeal or for filing such petition for certiorari has expired. Thereafter, and after final appellate determination of the claim of the Lourdes Blanco Stonehill Children's Trust (more correctly known as the Stonehill Family Trust) relating to the ownership of shares of stock of

Tower Development Corporation and the issue of whether plaintiff is entitled to the liquidation of Tower Development Corporation (involving the claims of defendants Ben Gromet, Tower Development Corporation and William Saunders), plaintiff may foreclose against any assets belonging to defendants Harry S. Stonehill and Robert P. Brooks within the jurisdiction of this Court to the extent that assets under the jurisdiction of the Central District of California shall be insufficient to satisfy said Judgment.

4. All other parties to this action recover nothing and their claims are dismissed with prejudice.

DATED this 10th day of October, 1980.

*Gus J. Solomon*
United States District Judge

## APPENDIX J

### Federal Rules of Criminal Procedure

### Rule 6. The Grand Jury

. . . . .

*(e) Recording and Disclosure of Proceedings.*

*(1) Recording of Proceedings.*—All proceedings, except when the grand jury is deliberating or voting, shall be recorded stenographically or by an electronic recording device. An unintentional failure of any recording to reproduce all or any portion of a proceeding shall not affect the validity of the prosecution. The recording or reporter's notes or any transcript prepared therefrom shall remain in the custody or control of the attorney for the government unless otherwise ordered by the court in a particular case.

*(2) General Rule of Secrecy.*—A grand juror, an interpreter, a stenographer, an operator of a recording device, a typist who transcribes recorded testimony, an attorney for the government, or any person to whom disclosure is made under paragraph (3)(A)(ii) of this subdivision shall not disclose matters occurring before the grand jury, except as otherwise provided for in these rules. No obligation of secrecy may be imposed on any person except in accordance with this rule. A knowing violation of Rule 6 may be punished as a contempt of court.

*(3) Exceptions.*

(A) Disclosure otherwise prohibited by this rule of matters occurring before the grand jury, other than

its deliberations and the vote of any grand juror, may be made to —

(i) an attorney for the government for use in the performance of such attorney's duty; and

(ii) such government personnel as are deemed necessary by an attorney for the government to assist an attorney for the government in the performance of such attorney's duty to enforce federal criminal law.

(B) Any person to whom matters are disclosed under subparagraph (A)(ii) of this paragraph shall not utilize that grand jury material for any purpose other than assisting the attorney for the government in the performance of such attorney's duty to enforce federal criminal law. An attorney for the government shall promptly provide the district court, before which was impaneled the grand jury whose material has been so disclosed, with the names of the persons to whom such disclosure has been made.

(C) Disclosure otherwise prohibited by this rule of matters occurring before the grand jury may also be made —

(i) when so directed by a court preliminarily to or in connection with a judicial proceeding; or

(ii) when permitted by a court at the request of the defendant, upon a showing that grounds may exist for a motion to dismiss the indictment because of matters occuring before the grand jury.

If the court orders disclosure of matters occur-

ring before the grand jury, the disclosure shall be made in such manner, at such time, and under such conditions as the court may direct.

*(4) Sealed Indictments.*—The federal magistrate to whom an indictment is returned may direct that the indictment be kept secret until the defendant is in custody or has been released pending trial. Thereupon the clerk shall seal the indictment and no person shall disclose the return of the indictment except when necessary for the issuance and evecution of a warrant or summons.